

*United States Senate*

***PERMANENT SUBCOMMITTEE ON INVESTIGATIONS***

*Committee on Homeland Security and Governmental Affairs*

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*Carl Levin, Chairman*

*John McCain, Ranking Minority Member*

# **E X H I B I T S**

**Hearing On**

***Offshore Profit Shifting and the U.S. Tax Code  
Part 2 (Apple Inc.)***

**May 21, 2013**

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***199 Russell Senate Office Building, Washington, D.C. 20510***

**EXHIBIT LIST**

**Hearing On**

***Offshore Profit Shifting and the  
U.S. Tax Code - Part 2 (Apple Inc.)***

**May 21, 2013**

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  - c. *Effect of Check the Box*, chart prepared by the Permanent Subcommittee on Investigations, Source: Materials received from Apple Inc.
  - d. *Apple's Current Operating Structure*. Source: Apple Inc.
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2. Excerpt (cover and signature page) from *Amended & Restated Cost Sharing Agreement Between Apple Inc., Apple Operations Europe & Apple Sales International*, May 2008. [APL-PSI-000020, 034]
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4. Correspondence between Ernst & Young and Cork, Ireland Office of the Revenue Commissioners, dated September 2004, regarding Apple Computer Inc Ltd, *The company is a non-resident holding company and is non-trading. In the circumstances there is nothing to return from the corporation tax standpoint.* [APL-PSI-000336-337]
5. *Apple Operations International - 2009-2012 Shareholder Meetings.* [APL-PSI-000340]
6. Excerpt from June 22, 2012 information supplied by Apple to the Permanent Subcommittee on Investigations, *...table identifies the Board Members and Corporate Officers of Apple's Irish entities...; Since the early 1990's, the Government of Ireland has calculated Apple's taxable income in such a way as to produce an effective rate in the low single digits.... The rate has varied from year to year, but since 2003 has been 2% or less.* [PSI-Apple-02-0002-005]
7. Excerpt from July 6, 2012 information supplied by Apple to the Permanent Subcommittee on Investigations, *...its principal offshore trading activities take place in Ireland and through Apple Distribution International and in Singapore through Apple South Asia Pte, Ltd.; What percentage amount of your company's world-wide revenues were: booked or recorded in the U.S.?.; Cash Reserves and Amounts Paid to Top 5 non-U.S. Subsidiaries.* [APL-PSI-000081, 098-108, 120]
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9. Excerpt from September 12, 2012 information supplied by Apple to the Permanent Subcommittee on Investigations, *Apple Operations International - 2009-2011 Minutes.* [APL-PSI-000323]
10. Excerpt from January 11, 2013 and 18, 2013 information supplied by Apple to the Permanent Subcommittee on Investigations, *Since its inception, Apple determined that AOI was not a tax resident of Ireland.; Apples does not believe that AOI qualifies as a tax resident of any other country under the applicable local laws.; For the past three fiscal years, AOI has not filed any corporate income taxes with any national government.* [APL-PSI-000236, 239-240]
11. Excerpt from March 11, 2013 information supplied by Apple to the Permanent Subcommittee on Investigations, *To the best of our knowledge, AOI does not meet any of the Irish central management and control factors.; The conclusion that AOI is not managed and controlled in Ireland does not require a determination where AOI is managed and controlled.* [APL-PSI-000241-248]

12. Excerpt from March 11, 2013 information supplied by Apple to the Permanent Subcommittee on Investigations, *MINUTES OF A MEETING OF THE BOARD OF DIRECTORS OF APPLE OPERATIONS EUROPE; IT WAS NOTED that the Company was to receive on 18<sup>th</sup> November 2010 a dividend in the amount of US \$1,750,000,000 from Apple Sales International; ...an interim dividend ... be paid in the total amount of US \$1,750,000,000 on the 18<sup>th</sup> of November 2010, to Apple Operations International....* [APL-PSI-000288-289]
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14. Excerpt from May 3, 2013 information supplied by Apple to the Permanent Subcommittee on Investigations, *Apple Operations International - FY 08 and FY 12 Board of Directors Meeting Information.* [APL-PSI-000349]
15. Excerpt from May 12, 2013 information supplied by Apple to the Permanent Subcommittee on Investigations, *AOE and ASI are participants in a Cost Sharing Arrangement with Apple Inc whereby AOE, ASI and Apple Inc have agreed to pool their resources for purposes of undertaking intellectual property co-development activities....* [APL-PSI-000351-353]
16. Excerpt from May 16, 2013 information supplied by Apple to the Permanent Subcommittee on Investigations, *IRC section 954(d) generally does not apply to income received by ASI or any of Apple's other Irish entities during the period 2008 to present because sales made to third parties are generally made through disregarded entities.* [APL-PSI-000381-383, 386]
17. Excerpt from May 17, 2013 information supplied by Apple to the Permanent Subcommittee on Investigations, *The individual who signed the relevant agreements for Apple Sales International was a U.S.-based Apple Inc. employee who signed the agreement in his capacity as Director of Apple Sales International.* [APL-PSI-000392, 396]
18. *Apple Inc. 10-K Select Figures, 2009-2012*, with excerpts from 10-K filings.
19. *Foreign Indefinitely Reinvested Earnings: Balances Held By The Russell 3000, A 5-Year Snapshot, May 2013*, prepared by Audit Analytics.

**MEMORANDUM**

TO: Members of the Permanent Subcommittee on Investigations

FROM: Senator Carl Levin, Chairman  
Senator John McCain, Ranking Minority Member  
Permanent Subcommittee on Investigations

DATE: May 21, 2013

RE: **Offshore Profit Shifting and the U.S. Tax Code - Part 2 (Apple Inc.)**

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## I. EXECUTIVE SUMMARY

On May 21, 2013, the Permanent Subcommittee on Investigations (PSI) of the U.S. Senate Homeland Security and Government Affairs Committee will hold a hearing that is a continuation of a series of reviews conducted by the Subcommittee on how individual and corporate taxpayers are shifting billions of dollars offshore to avoid U.S. taxes. The hearing will examine how Apple Inc., a U.S. multinational corporation, has used a variety of offshore structures, arrangements, and transactions to shift billions of dollars in profits away from the United States and into Ireland, where Apple has negotiated a special corporate tax rate of less than two percent. One of Apple's more unusual tactics has been to establish and direct substantial funds to offshore entities in Ireland, while claiming they are not tax residents of any jurisdiction. For example, Apple Inc. established an offshore subsidiary, Apple Operations International, which from 2009 to 2012 reported net income of \$30 billion, but declined to declare any tax residence, filed no corporate income tax return, and paid no corporate income taxes to any national government for five years. A second Irish affiliate, Apple Sales International, received \$74 billion in sales income over four years, but due in part to its alleged status as a non-tax resident, paid taxes on only a tiny fraction of that income.

In addition, the hearing will examine how Apple Inc. transferred the economic rights to its intellectual property through a cost sharing agreement with its own offshore affiliates, and was thereby able to shift tens of billions of dollars offshore to a low tax jurisdiction and avoid U.S. tax. Apple Inc. then utilized U.S. tax loopholes, including the so-called "check-the-box" rules, to avoid U.S. taxes on \$44 billion in taxable offshore income over the past four years, or about \$10 billion in tax avoidance per year. The hearing will also examine some of the weaknesses and loopholes in certain U.S. tax code provisions, including transfer pricing, Subpart F, and related regulations, that enable multinational corporations to avoid U.S. taxes.

### A. Subcommittee Investigation

For a number of years, the Subcommittee has reviewed how U.S. citizens and multinational corporations have exploited and, at times, abused or violated U.S. tax statutes, regulations and accounting rules to shift profits and valuable assets offshore to avoid U.S. taxes. The Subcommittee inquiries have resulted in a series of hearings and reports.<sup>1</sup> The Subcommittee's recent reviews have focused on how multinational corporations have employed various complex structures and transactions to exploit taxloopholes to shift large portions of their profits offshore and dodge U.S. taxes.

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<sup>1</sup> See, e.g., U.S. Senate Permanent Subcommittee on Investigations, "Fishtail, Bacchus, Sundance, and Slapshot: Four Enron Transactions Funded and Facilitated by U.S. Financial Institutions," S.Prt. 107-82 (Jan. 2, 2003); "U.S. Tax Shelter Industry: The Role of Accountants, Lawyers, and Financial Professionals," S.Hrg. 108-473 (No. 18 and 20, 2003); "Tax Haven Abuses: The Enablers, The Tools and Secrecy," S.Hrg. 109-797 (Aug. 1, 2006); "Tax Haven Banks and U.S. Tax Compliance," S.Hrg. 110-614 (July 17 and 25, 2008); "Tax Haven Banks and U.S. Tax Compliance: Obtaining the Names of U.S. Clients with Swiss Accounts," S.Hrg. 111-30 (Mar. 4, 2009); "Repatriating Offshore Funds: 2004 Tax Windfall for Select Multinationals," S.Prt. 112-27 (Oct. 11, 2011); and "Offshore Profit Shifting and the U.S. Tax Code – Part 1 (Microsoft and Hewlett-Packard)," S.Hrg.112-\*\*\* (Sept. 20, 2012).

At the same time as the U.S. federal debt has continued to grow – now surpassing \$16 trillion – the U.S. corporate tax base has continued to decline, placing a greater burden on individual taxpayers and future generations. According to a report prepared for Congress:

“At its post-WWII peak in 1952, the corporate tax generated 32.1% of all federal tax revenue. In that same year the individual tax accounted for 42.2% of federal revenue, and the payroll tax accounted for 9.7% of revenue. Today, the corporate tax accounts for 8.9% of federal tax revenue, whereas the individual and payroll taxes generate 41.5% and 40.0%, respectively, of federal revenue.”<sup>2</sup>

Over the past several years, the amount of permanently reinvested foreign earnings reported by U.S. multinationals on their financial statements has increased dramatically. One study has calculated that undistributed foreign earnings for companies in the S&P 500 have increased by more than 400%.<sup>3</sup> According to recent analysis by Audit Analytics, over a five year period from 2008 to 2012, total untaxed indefinitely reinvested earnings reported in 10-K filings for firms comprising the Russell 3000 increased by 70.3%.<sup>4</sup> During the same period, the number of firms reporting indefinitely reinvested earnings increased by 11.4%.

The increase in multinational corporate claims regarding permanently reinvested foreign earnings and the decline in corporate tax revenue are due in part to the shifting of mobile income offshore into tax havens. A number of studies show that multinational corporations are moving “mobile” income out of the United States into low or no tax jurisdictions, including tax havens such as Ireland, Bermuda, and the Cayman Islands.<sup>5</sup> In one 2012 study, a leading expert in the Office of Tax Analysis of the U.S. Department of Treasury found that foreign profit margins, not foreign sales, are the cause for significant increases in profits abroad. He wrote:

“The foreign share of the worldwide income of U.S. multinational corporations (MNCs) has risen sharply in recent years. Data from a panel of 754 large MNCs indicate that the MNC foreign income share increased by 14 percentage points from 1996 to 2004. The differential between a company’s U.S. and foreign effective tax rates exerts a significant effect on the share of its income abroad, largely through changes in foreign and domestic profit margins rather than a shift in sales. U.S.-foreign tax differentials are estimated to have raised the foreign share of MNC worldwide income by about 12 percentage points by 2004. Lower foreign effective tax rates had no significant effect on a company’s domestic sales or on the growth of its worldwide pre-tax profits. Lower taxes on foreign income do not seem to promote ‘competitiveness.’”<sup>6</sup>

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<sup>2</sup> 12/8/2011 “Reasons for the Decline in the Corporate Tax Revenues” Congressional Research Service, Mark P. Keightley, at.1. See also 4/2011 “Tax Havens and Treasure Hunts,” *Today’s Economist*, Nancy Folbre.

<sup>3</sup> 4/26/2011 “Parking Earnings Overseas,” Zion, Varsheny, Burnap: Credit Suisse, at 3.

<sup>4</sup> 5/1/2013 Audit Analytics, “Foreign Indefinitely Reinvested Earnings: Balances Held by the Russell 3000.”

<sup>5</sup> See, e.g., 6/5/2010 “Tax Havens: International Tax Avoidance and Evasion,” Congressional Research Service, Jane Gravelle, at 15 (citing multiple studies).

<sup>6</sup> 2/2012 “Foreign Taxes and the Growing Share of U.S. Multinational Company Income Abroad: Profits, Not Sales, are Being Globalized,” Office of Tax Analysis Working Paper 103, U.S. Department of Treasury, Harry Grubert, at 1.

One study showed that foreign profits of controlled foreign corporations (CFCs) of U.S. multinationals significantly outpace the total GDP of some tax havens.”<sup>7</sup> For example, profits of CFCs in Bermuda were 645% and in the Cayman Islands were 546% as a percentage of GDP, respectively. In a recent research report, JPMorgan expressed the opinion that the transfer pricing of intellectual property “explains some of the phenomenon as to why the balances of foreign cash and foreign earnings at multinational companies continue to grow at such impressive rates.”<sup>8</sup>

On September 20, 2012, the Subcommittee held a hearing and examined some of the weaknesses and loopholes in certain tax and accounting rules that facilitated profit shifting by multinational corporations. Specifically, it reviewed transfer pricing, deferral, and Subpart F of the Internal Revenue Code, with related regulations, and accounting standards governing offshore profits and the reporting of tax liabilities. The Subcommittee presented two case studies: (1) a study of structures and practices employed by Microsoft Corporation to shift and keep profits offshore; and (2) a study of Hewlett-Packard’s “staggered foreign loan program,” which was devised to *de facto* repatriate offshore profits to the United States to help run its U.S. operations, without paying U.S. taxes.

The case study for the Subcommittee’s May 2013 hearing involves Apple Inc. Building upon information collected in previous inquiries, the Subcommittee reviewed Apple responses to several Subcommittee surveys, reviewed Apple SEC filings and other documents, requested information from Apple, and interviewed a number of corporate representatives from Apple. The Subcommittee also consulted with a number of tax experts and the IRS.

This memorandum first provides an overview of certain tax provisions related to offshore income, such as transfer pricing, Subpart F, and the so-called check-the-box regulations and look-through rule. It then presents a case study of Apple’s organizational structure and the provisions of the tax code and regulations it uses to shift and keep billions in profits offshore in two controlled foreign corporations formed in Ireland. The first is Apple Sales International (ASI), an entity that has acquired certain economic rights to Apple’s intellectual property. Apple Inc. has used those rights of ASI to shift billions in profits away from the United States to Ireland, where it pays a corporate tax rate of 2% or less. The second is Apple Operations International (AOI), a 30-year old corporation that has no employees or physical presence, and whose operations are managed and controlled out of the United States. Despite receiving \$30 billion in earnings and profits during the period 2009 through 2011 as the key holding company for Apple’s extensive offshore corporate structure, Apple Operations International has no declared tax residency anywhere in the world and, as a consequence, has not paid corporate income tax to any national government for the past 5 years. Apple has recently disclosed that ASI also claims to have no tax residency in any jurisdiction, despite receiving over a four year period from 2009 to 2012, sales income from Apple affiliates totaling \$74 billion.

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<sup>7</sup> 6/5/2010 “Tax Havens: International Tax Avoidance and Evasion,” Congressional Research Service, Jane Gravelle, at 14.

<sup>8</sup> 5/16/2012 “Global Tax Rate Makers,” JPMorgan Chase, at 2 (based on research of SEC filings of over 1,000 reporting issuers).



Apple is an American success story. Today, Apple Inc. maintains more than \$102 billion in offshore cash, cash equivalents and marketable securities (cash).<sup>9</sup> Apple executives told the Subcommittee that the company has no intention of returning those funds to the United States unless and until there is a more favorable environment, emphasizing a lower corporate tax rate and a simplified tax code.<sup>10</sup> Recently, Apple issued \$17 billion in debt instruments to provide funds for its U.S. operations rather than bring its offshore cash home, pay the tax owed, and use those funds to invest in its operations or return dividends to its stockholders. The Subcommittee's investigation shows that Apple has structured organizations and business operations to avoid U.S. taxes and reduce the contribution it makes to the U.S. treasury. Its actions disadvantage Apple's domestic competitors, force other taxpayers to shoulder the tax burden Apple has cast off, and undermine the fairness of the U.S. tax code. The purpose of the Subcommittee's investigation is to describe Apple's offshore tax activities and offer recommendations to close the offshore tax loopholes that enable some U.S. multinational corporations to avoid paying their share of taxes.

## **B. Findings and Recommendations**

**Findings.** The Subcommittee's investigation has produced the following findings of fact.

1. **Shifting Profits Offshore.** Apple has \$145 billion in cash, cash equivalents and marketable securities, of which \$102 billion is "offshore." Apple has used offshore entities, arrangements, and transactions to transfer its assets and profits offshore and minimize its corporate tax liabilities.
2. **Offshore Entities With No Declared Tax Jurisdiction.** Apple has established and directed tens of billions of dollars to at least two Irish affiliates, while claiming neither is a tax resident of any jurisdiction, including its primary offshore holding company, Apple Operations International (AOI), and its primary intellectual property rights recipient, Apple Sales International (ASI). AOI, which has no employees, has no physical presence, is managed and controlled in the United States, and received \$30 billion of income between 2009 and 2012, has paid no corporate income tax to any national government for the past five years.
3. **Cost Sharing Agreement.** Apple's cost sharing agreement (CSA) with its offshore affiliates in Ireland is primarily a conduit for shifting billions of dollars in income from the United States to a low tax jurisdiction. From 2009 to 2012, the CSA facilitated the shift of \$74 billion in worldwide sales income away from the United States to Ireland where Apple has negotiated a tax rate of less than 2%.
4. **Circumventing Subpart F.** The intent of Subpart F of the U.S. tax code is to prevent multinational corporations from shifting profits to tax havens to avoid U.S. tax. Apple has exploited weaknesses and loopholes in U.S. tax laws and regulations, particularly the "check-the-box" and "look-through" rules, to circumvent Subpart F

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<sup>9</sup> 4/23/2013 Apple Second Quarter Earnings Call, Fiscal Year 2013, <http://www.nasdaq.com/aspx/call-transcript.aspx?StoryId=1364041&Title=apple-s-ceo-discusses-f2q13-results-earnings-call-transcript>.

<sup>10</sup> Subcommittee interview of Apple Chief Executive Officer Tim Cook (4/29/2013).

taxation and, from 2009 to 2012, avoid \$44 billion in taxes on otherwise taxable offshore income.

**Recommendations.** Based upon the Subcommittee's investigation, the Memorandum makes the following recommendations.

1. **Strengthen Section 482.** Strengthen Section 482 of the tax code governing transfer pricing to eliminate incentives for U.S. multinational corporations to transfer intellectual property to shell entities that perform minimal operations in tax haven or low tax jurisdictions by implementing more restrictive transfer pricing rules concerning intellectual property.
2. **Reform Check-the-Box and Look Through Rules.** Reform the "check-the-box" and "look-through" rules so that they do not undermine the intent of Subpart F of the Internal Revenue Code to currently tax certain offshore income.
3. **Tax CFCs Under U.S. Management and Control.** Use the current authority of the IRS to disregard sham entities and impose current U.S. tax on income earned by any controlled foreign corporation that is managed and controlled in the United States.
4. **Properly Enforce Same Country Exception.** Use the current authority of the IRS to restrict the "same country exception" so that the exception to Subpart F cannot be used to shield from taxation passive income shifted between two related entities which are incorporated in the same country, but claim to be in different tax residences without a legitimate business reason.
5. **Properly Enforce the Manufacturing Exception.** Use the current authority of the IRS to restrict the "manufacturing exception" so that the exception to Subpart F cannot be used to shield offshore income from taxation unless substantial manufacturing activities are taking place in the jurisdiction where the intermediary CFC is located.

## II. OVERVIEW OF TAX PRINCIPLES AND LAW

### A. U.S. Worldwide Tax and Deferral

U.S. corporations are subject to a statutory tax rate of up to a 35% on all their income, including worldwide income, which on its face is a rate among the highest in the world. This statutory tax rate can be reduced, however, through a variety of mechanisms, including tax provisions that permit multinational corporations to defer U.S. tax on active business earnings of their CFCs until those earnings are brought back to the United States, *i.e.*, repatriated as a dividend. The ability of a U.S. firm to earn foreign income through a CFC without US tax until the CFC's earnings are paid as a dividend is known as "deferral." Deferral creates incentives for U.S. firms to shift U.S. earnings offshore to low tax or no tax jurisdictions to avoid U.S. taxes and increase their after tax profits. In other words, tax haven deferral is done for tax avoidance purposes.<sup>11</sup> U.S. multinational corporations shift large amounts of income to low-tax foreign jurisdictions, according to a 2010 report by the Joint Committee on Taxation.<sup>12</sup> Current estimates indicate that U.S. multinationals have more than \$1.7 trillion in undistributed foreign earnings and keep at least 60% of their cash overseas.<sup>13</sup> In many instances, the shifted income is deposited in the names of CFCs in accounts in U.S. banks.<sup>14</sup> In 2012, President Barack Obama reiterated concerns about such profit shifting by U.S multinationals and called for this problem to be addressed through tax reform.<sup>15</sup>

### B. Transfer Pricing

A major method used by multinationals to shift profits from high-tax to low-tax jurisdictions is through the pricing of certain intellectual property rights, goods and services sold between affiliates. This concept is known as "transfer pricing." Principles regarding transfer pricing are codified under Section 482 of the Internal Revenue Code and largely build upon the principle of arms length dealings. IRS regulations provide various economic methods that can be used to test the arm's length nature of transfers between related parties. There are several ways in which assets or services are transferred between a U.S. parent and an offshore affiliate entity: an outright sale of the asset; a licensing agreement where the economic rights are transferred to the affiliate in exchange for a licensing fee or royalty stream; a sale of services; or a cost sharing agreement, which is an agreement between related entities to share the cost of developing an intangible asset and a proportional share of the rights to the intellectual property

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<sup>11</sup> See 12/2000 "The Deferral of Income Earned through U.S. Controlled Foreign Corporations," Office of Tax Policy, U.S. Department of Treasury, at 12.

<sup>12</sup> 7/20/2010 "Present Law and Background Related to Possible Income Shifting and Transfer Pricing," Joint Committee on Taxation, (JCX-37-10), at 7.

<sup>13</sup> 5/16/2012 "Global Tax Rate Makers," JP Morgan Chase, at 1; see also 4/26/11 "Parking Earnings Overseas," Credit Suisse.

<sup>14</sup> See, e.g., U.S. Senate Permanent Subcommittee on Investigations, "Repatriating Offshore Funds: 2004 Tax Windfall for Select Multinationals," S.Rpt. 112-27 (Oct. 11, 2011)(showing that of \$538 billion in undistributed accumulated foreign earnings at the end of FY2010 at 20 U.S. multinational corporations, nearly half (46%) of the funds that the corporations had identified as offshore and for which U.S. taxes had been deferred, were actually in the United States at U.S. financial institutions).

<sup>15</sup> See 2/22/2012 "The President's Framework for Business Tax Reform," <http://www.treasury.gov/resource-center/tax-policy/Documents/The-Presidents-Framework-for-Business-Tax-Reform-02-22-2012.pdf>.

that results. A cost sharing agreement typically includes a “buy-in” payment from the affiliate, which supposedly compensates the parent for transferring intangible assets to the affiliate and for incurring the initial costs and risks undertaken in initially developing or acquiring the intangible assets.

The Joint Committee on Taxation has stated that a “principal tax policy concern is that profits may be artificially inflated in low-tax countries and depressed in high-tax countries through aggressive transfer pricing that does not reflect an arms-length result from a related-party transaction.”<sup>16</sup> A study by the Congressional Research Service raises the same issue. “In the case of U.S. multinationals, one study suggested that about half the difference between profitability in low-tax and high-tax countries, which could arise from artificial income shifting, was due to transfers of intellectual property (or intangibles) and most of the rest through the allocation of debt.”<sup>17</sup> A Treasury Department study conducted in 2007 found the potential for improper income shifting was “most acute with respect to cost sharing arrangements involving intangible assets.”<sup>18</sup>

Valuing intangible assets at the time they are transferred is complex, often because of the unique nature of the asset, which is frequently a new invention without comparable prices, making it hard to know what an unrelated third party would pay for a license. According to one recent study by JPMorgan Chase:

“Many multinationals appear to be centralizing many of their valuable IP [intellectual property] assets in low-tax jurisdictions. The reality is that IP rights are easily transferred from jurisdiction to jurisdiction, and they are often inherently difficult to value.”<sup>19</sup>

The inherent difficulty in valuing such assets enables multinationals to artificially increase profits in low tax jurisdictions using aggressive transfer pricing practices. The Economist has described these aggressive transfer pricing tax strategies as a “big stick in the corporate treasurer’s tax-avoidance armoury.”<sup>20</sup> Certain tax experts, who had previously served in senior government tax positions, have described the valuation problems as insurmountable.<sup>21</sup>

Of various transfer pricing approaches, “licensing and cost-sharing are among the most popular and controversial.”<sup>22</sup> The legal ownership is most often not transferred outside the United States, because of the protections offered by the U.S. legal system and the importance of protecting such rights in such a large market; instead, only the economic ownership of certain

<sup>16</sup> 7/20/2010 “Present Law and Background Related to Possible Income Shifting and Transfer Pricing,” Joint Committee on Taxation, (JCX-37-10), at 5.

<sup>17</sup> 6/5/2010 “Tax Havens: International Tax Avoidance and Evasion,” Congressional Research Service, Jane Gravelle, at 8 (citing 3/2003 “Intangible Income, Intercompany Transactions, Income Shifting and the Choice of Locations,” National Tax Journal, vol. 56.2, Harry Grubert, at 221-42).

<sup>18</sup> 7/20/2010 “Present Law and Background Related to Possible Income Shifting and Transfer Pricing,” Joint Committee on Taxation, (JCX-37-10), at 7 (citing November 2007 “Report to the Congress on Earnings Stripping, Transfer Pricing and U.S. Income Tax Treaties,” U.S. Treasury Department).

<sup>19</sup> 5/16/2012 “Global Tax Rate Makers,” JPMorgan Chase, at 1.

<sup>20</sup> 2008 “An Introduction to Transfer Pricing,” New School Economic Review, vol. 3.1, Alfredo J. Urquidi, at 28 (citing “Moving Pieces,” *The Economist*, 2/22/2007).

<sup>21</sup> 3/20/2012 “IRS Forms ‘SWAT Team’ for Tax Dodge Crackdown,” Reuters, Patrick Temple-West.

<sup>22</sup> 5/16/2012 “Global Tax Rate Makers,” JPMorgan Chase, at 20.

specified rights to the property is transferred. Generally in a cost sharing agreement, a U.S. parent and one or more of its CFCs contribute funds and resources toward the joint development of a new product.<sup>23</sup> The Joint Committee on Taxation has explained:

“The arrangement provides that the U.S. company owns legal title to, and all U.S. marketing and production rights in, the developed property, and that the other party (or parties) owns rights to all marketing and production for the rest of the world. Reflecting the split economic ownership of the newly developed asset, no royalties are shared between cost sharing participants when the product is ultimately marketed and sold to customers.”<sup>24</sup>

The tax rules governing cost sharing agreements are provided in Treasury Regulations that were issued in December 2011.<sup>25</sup> These regulations were previously issued as temporary and proposed regulations in December 2008. The Treasury Department explained that cost sharing arrangements “have come under intense scrutiny by the IRS as a potential vehicle for improper transfer of taxable income associated with intangible assets.”<sup>26</sup> The regulations provide detailed rules for evaluating the compensation received by each participant for its contribution to the agreement<sup>27</sup> and tighten the rules to “ensure that the participant making the contribution of platform intangibles will be entitled to the lion’s share of the expected returns from the arrangement, as well as the actual returns from the arrangement to the extent they materially exceed the expected returns.”<sup>28</sup> Under these rules, related parties may enter into an arrangement under which the parties share the costs of developing one or more intangibles in proportion to each party’s share of reasonably anticipated benefits from the cost shared intellectual asset.<sup>29</sup> The regulations also provided for transitional grandfathering rules for cost sharing entered into prior to the 2008 temporary regulations. As a result of the changes in the regulations, multinational taxpayers have worked to preserve the grandfathered status of their cost sharing arrangements

### **C. Transfer Pricing and the Use of Shell Corporations**

The Subcommittee’s investigations, as well as government and academic studies, have shown that U.S. multinationals use transfer pricing to move the economic rights of intangible assets to CFCs in tax havens or low tax jurisdictions, while they attribute expenses to their U.S. operations, lowering their taxable income at home.<sup>30</sup> Their ability to artificially shift income to a

<sup>23</sup> 7/20/2010 “Present Law and Background Related to Possible Income Shifting and Transfer Pricing,” Joint Committee on Taxation, (JCX-37-10), at 21.

<sup>24</sup> Id.

<sup>25</sup> Treas. Reg. §1.482-7.

<sup>26</sup> 1/25/2012 “U.S. Department of Treasury issues final cost sharing regulations,” International Tax News, Paul Flignor.

<sup>27</sup> 7/20/2010 “Present Law and Background Related to Possible Income Shifting and Transfer Pricing,” Joint Committee on Taxation, (JCX-37-10), at 25.

<sup>28</sup> 1/14/2009 “IRS Issues Temporary Cost Sharing Regulations Effective Immediately” International Alert, Miller Chevalier.

<sup>29</sup> 12/12/2012 “Final Section 482 Cost Sharing Regulations: A Renewed Commitment to the Income Method,” Bloomberg BNA, Andrew P. Solomon.

<sup>30</sup> U.S. Senate Permanent Subcommittee on Investigations, “Offshore Profit Shifting and the U.S. Tax Code – Part 1 (Microsoft and Hewlett-Packard),” S.Hrg.112-\*\*\* (Sept. 20, 2012).

tax haven provides multinationals with an unfair advantage over U.S. domestic corporations; it amounts to a subsidy for those multinationals. The recipient CFC in many cases is a shell entity that is created for the purpose of holding the rights. Shell companies are legal entities without any substantive existence - they have no employees, no physical presence, and produce no goods or services. Such shell companies are “ubiquitous in U.S international tax planning.”<sup>31</sup> Typically, multinationals set up a shell corporation to enable it to artificially shift income to shell subsidiaries in low tax or tax haven jurisdictions.

According to a 2008 GAO study, “eighty-three of the 100 largest publicly traded U.S. corporations in terms of revenue reported having subsidiaries in jurisdictions list as tax havens or financial privacy jurisdictions....”<sup>32</sup> Many of the largest U.S. multinationals use shell corporations to hold the economic rights to intellectual property and the profits generated from those rights in tax haven jurisdictions to avoid U.S. taxation.<sup>33</sup> By doing this, multinational companies are shifting taxable U.S. income on paper to affiliated offshore shells. These strategies are causing the United States to lose billions of tax dollars annually.

Moreover, from a broader prospective, multinationals are able to benefit from the tax rules which assume that different entities of a multinational, including shell corporations, act independently from one another. The reality today is that the entities of a parent multinational typically operate as one global enterprise following a global business plan directed by the U.S. parent. If that reality were recognized, rather than viewing the various affiliated entities as independent companies, they would not be able to benefit from creating fictitious entities in tax havens and shifting income to those entities. In fact, when Congress enacted Subpart F, discussed in detail below, more than fifty years ago in 1962, an express purpose of that law was to stop the deflection of multinational income to tax havens, an activity which is so prevalent today.

#### **D. Piercing the Veil – Instrumentality of the Parent**

It has long been understood that a shell corporation could be at risk of being disregarded for U.S. tax purposes “if one entity so controls the affairs of a subsidiary that it ‘is merely an instrumentality of the parent.’”<sup>34</sup> Courts have applied the “piercing the corporate veil” doctrine, a common law concept, when determining whether to disregard the separateness of two related

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<sup>31</sup> Testimony of Professor Reuven S. Avi-Yonah, hearing before the U.S. Senate Committee on Finance, International Tax Issues, S.Hrg. 112-645 (9/8/2011).

<sup>32</sup> 12/4/2008 “Large U.S. Corporations and Federal Contractors with Subsidiaries in Jurisdictions Listed as Tax Havens or Financial Privacy Jurisdictions,” U.S. Government Accountability Office, No. GAO-09-157, at 4.

<sup>33</sup> See, e.g., 2/16/2013 “The price isn’t right: Corporate profit-shifting has become big business,” The Economist, Special Report.

<sup>34</sup> 2/2011 “Recent IRS determination Highlights Importance of Separation Among Affiliates,” by George E. Constantine, at 1, <http://www.venable.com/recent-irs-determination-highlights-importance-of-separation-among-affiliates-02-24-2011/> (originally published in February 2011 edition of Association Law and Policy, <https://www.asaecenter.org/Resources/EnewsletterArticleDetail.cfm?ItemNumber=57654>, (citing IRS Priv. Ltr. Rul. 2002-25-046 (Mar. 28, 2002), which cites Moline Properties v. Commissioner of Internal Revenue, 319 U.S. 436, 438 (1943); Britt v. United States, 431 F. 2d 227, 234 (5th Cir. 1970); and Krivo Indus. Supply Co. v. National Distillers and Chem. Corp., 483 F.2d 1098, 1106 (5th Cir. 1973)).

entities for corporate and tax liabilities.<sup>35</sup> It is a fact-specific analysis to determine whether the veil of a shell entity should be pierced for tax purposes. The courts over time have looked at such factors as: the financial support of the subsidiary's operations by the parent; the lack of substantial business contacts with anyone except the parent; and whether the property of the entity is used by each as if jointly owned.<sup>36</sup> Despite the availability of this tool to "sham" a corporation and pierce the corporate veil for tax purposes, the IRS and the courts have been hesitant to take action against shell foreign corporations or attribute the activities or income of a CFC to its U.S. parent.<sup>37</sup>

## **E. Subpart F To Prevent Tax Haven Abuse**

As early as the 1960s, "administration policymakers became concerned that U.S. multinationals were shifting their operations and excess earnings offshore in response to the tax incentive provided by deferral."<sup>38</sup> At that time, circumstances were somewhat similar to the situation in the United States today. "The country faced a large deficit and the Administration was worried that U.S. economic growth was slowing relative to other industrialized countries."<sup>39</sup> To help reduce the deficit, the Kennedy Administration proposed to tax the current foreign earnings of subsidiaries of multinationals and offered tax incentives to encourage investments at home.<sup>40</sup>

In the debates leading up to the passage of Subpart F, President Kennedy stated in an April 1961 tax message:

"The undesirability of continuing deferral is underscored where deferral has served as a shelter for tax escape through the unjustifiable use of tax havens such as Switzerland. Recently more and more enterprises organized abroad by American firms have arranged their corporate structures aided by artificial arrangements between parent and subsidiary regarding intercompany pricing, the transfer of patent licensing rights, the shifting of management fees, and similar practices which maximize the accumulation of profits in the tax haven as to exploit the multiplicity of foreign tax systems and international

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<sup>35</sup> Id. See also, e.g., Moline Properties v. Commissioner of Internal Revenue, 319 U.S. 436, 439 (1943) (holding that, for income tax purposes, a taxpayer cannot ignore the form of the corporation that he creates for a valid business purpose or that subsequently carries on business, unless the corporation is a sham or acts as a mere agent).

<sup>36</sup> Id.

<sup>37</sup> Id. See also Perry Bass v. Commissioner, 50 T.C. 595, 600 (1968) ("[A] taxpayer may adopt any form he desires for the conduct of his business, and ... the chosen form cannot be ignored merely because it results in a tax saving." However, the form the taxpayer chooses for conducting business that results in tax-avoidance "must be a viable business entity, that is, it must have been formed for a substantial business purpose or actually engage in substantive business activity.")

<sup>38</sup> 5/4/2006 "The Evolution of International Tax Policy- What Would Larry Say?" The Laurence Neal Woodworth Memorial Lecture in Federal Tax Law and Policy, Paul Oosterhuis, at 2, <http://www.taxanalysts.com/www/features.nsf/articles/3193a0ff95f96d378525726b006f4ad2?opendocument>.

<sup>39</sup> Id.

<sup>40</sup> Id. (citing 1/11/1962 "Annual Message to Congress on the State of the Union," President Kennedy 1 Pub. Papers, at 13-14).

agreements in order to reduce sharply or eliminate completely their tax liabilities both at home and abroad.”<sup>41</sup>

Although the Kennedy Administration initially proposed to end deferral of foreign source income altogether, a compromise was struck instead, which became known as Subpart F.<sup>42</sup> Subpart F was enacted by Congress in 1962, and was designed in substantial part to address the tax avoidance techniques being utilized today by U.S. multinationals in tax havens. In fact, to curb tax haven abuses, Congress enacted anti-tax haven provisions, despite extensive opposition by the business community.<sup>43</sup>

## F. Subpart F To Tax Current Income

Subpart F explicitly restricts the types of income whose taxation may be deferred, and it is often referred to as an “anti-deferral” regime. The Subpart F rules are codified in tax code Sections 951 to 965, which apply to certain income of CFCs.<sup>44</sup> When a CFC earns Subpart F income, the U.S. parent as shareholder is treated as having received the current income. Subpart F was enacted to deter U.S. taxpayers from using CFCs located in tax havens to accumulate earnings that could have been accumulated in the United States.<sup>45</sup> “[S]ubpart F generally targets passive income and income that is split off from the activities that produced the value in the goods or services generating the income,” according to the Treasury Department’s Office of Tax Policy.<sup>46</sup> In contrast, income that is generated by active, foreign business operations of a CFC continues to warrant deferral. But, again, deferral is not permitted for passive, inherently mobile income such as royalty, interest, or dividend income, as well as income resulting from certain other activities identified in Subpart F.<sup>47</sup> Income reportable under Subpart F is currently subject to U.S. tax, regardless of whether the earnings have been repatriated. However, regulations, temporary statutory changes, and certain statutory exceptions have nearly completely undercut the intended application of Subpart F.

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<sup>41</sup> 1961 “President’s Recommendations on Tax Revision: Hearings Before the House Ways and Means Committee,” reprinted in Richard A. Gordon, Tax Havens and Their Use by United States Taxpayers – An Overview, (2002), at 44.

<sup>42</sup> 5/4/2006 “The Evolution of International Tax Policy- What Would Larry Say?” The Laurence Neal Woodworth Memorial Lecture in Federal Tax Law and Policy, Paul Oosterhuis, at 3, <http://www.taxanalysts.com/www/features.nsf/articles/3193a0ff95f96d378525726b006f4ad2?opendocument>.

<sup>43</sup> See, e.g., 12/2000 “The Deferral of Income Earned through U.S. Controlled Foreign Corporations,” Office of Tax Policy, U.S. Department of Treasury, at 21.

<sup>44</sup> A CFC is a foreign corporation more than 50% of which, by vote or value, is owned by U.S. persons owning a 10% or greater interest in the corporation by vote (“U.S. shareholders”). “U.S. persons” include U.S. citizens, residents, corporations, partnerships, trusts and estates. IRC Section 957.

<sup>45</sup> See Koehring Company v. United States of America, 583 F.2d 313 (7th Cir. 1978). See also 12/2000 “The Deferral of Income Earned through U.S. Controlled Foreign Corporations,” Office of Tax Policy, U.S. Department of Treasury, at xii.

<sup>46</sup> 12/2000 “The Deferral of Income Earned through U.S. Controlled Foreign Corporations,” Office of Tax Policy, U.S. Department of Treasury, at xii.

<sup>47</sup> IRC Section 954(c).



## G. Check-the-Box Regulations and Look Through Rule

“Check-the-box” tax regulations issued by the Treasury Department in 1997, and the CFC “look-through rule” first enacted by Congress as a temporary measure in 2006, have significantly reduced the effectiveness of the anti-deferral rules of Subpart F and have further facilitated the increase in offshore profit shifting, which has gained significant momentum over the last 15 years. Treasury issued the check-the-box regulations which became effective on January 1, 1997. Treasury stated at the time that the regulations were designed to simplify tax rules for determining whether an entity is a corporation, a partnership, a sole proprietorship, branch or disregarded entity (DRE) for federal tax purposes.<sup>48</sup> The regulations eliminated a multi-factor test in determining the proper classification of an entity in favor of a simple, elective “check-the-box” regime. Treasury explained that the rules were intended to solve two problems that had developed for the IRS. First, the rise of limited liability companies (LLCs) domestically had placed stress on the multi-factor test, which determined different state and federal tax treatment for them. Second, international entity classification was dependent upon foreign law, making IRS classification difficult and complex. Check-the-box was intended to eliminate the complexity and uncertainty inherent in the test, allowing entities to simply select their tax treatment.

The regulations, however, had significant unintended consequences and opened the door to a host of tax avoidance schemes. Under Subpart F, passive income paid from one separate legal entity to another separate legal entity – even if they were both within the same corporate structure – was immediately taxable. However, with the implementation of the check-the-box regulations, a U.S. multinational could set up a CFC subsidiary in a tax haven and direct it to receive passive income such as interest, dividend, or royalty payments from a lower tiered related CFC without it being classified as Subpart F income. The check-the-box rule permitted this development, because it enabled the multinational to choose to have the lower tiered CFC disregarded or ignored for federal tax purposes. In other words, the lower tiered CFC, although it was legally still a separate entity, would be viewed as part of the higher tiered CFC and not as a separate entity for tax purposes. Therefore, for tax purposes, any passive income paid by the lower tiered entity to the higher tiered CFC subsidiary would not be considered as a payment between two legally separate entities and, thus, would not constitute taxable Subpart F income. The result was that the check-the-box regulations enabled multinationals for tax purposes to ignore the facts reported in their books – which is that they received passive income. Similarly, check-the-box can be used to exclude other forms of Subpart F income, including Foreign Base Company Sales Income, discussed below.

Recognizing this inadvertent problem, the IRS and Treasury issued Notice 98-11 on February 9, 1998, reflecting concerns that the check-the-box regulations were facilitating the use of what the agencies refer to as “hybrid branches” to circumvent Subpart F. “The notice defined a hybrid branch as an entity with a single owner that is treated as a separate entity under the relevant tax laws of a foreign country and as a branch (i.e., DRE) of a CFC that is its sole owner for U.S. tax purposes.”<sup>49</sup> The Notice stated: “Treasury and the Service have concluded that the

<sup>48</sup> IRC Sections 301.7701-1 through 301.7701-3 (1997).

<sup>49</sup> 7/20/2010 “Present Law and Background Related to Possible Income Shifting and Transfer Pricing,” Joint Committee on Taxation, (JCX-37-10), at 48.

use of certain hybrid branch arrangements [described in Examples 1 and 2 of the Notice] is contrary to the policies and rules of subpart F. This notice (98-11) announces that Treasury and the Service will issue regulations to address such arrangements.”<sup>50</sup>

On March 26, 1998, Treasury and the IRS proposed regulations to close the loophole opened by the check-the-box rule to prevent the unintended impact to Subpart F. Recognizing that neither had the authority to change the tax law, the IRS and Treasury stated in the proposed rule “the administrative provision [check-the-box] was not intended to change substantive law. Particularly in the international area, the ability to more easily achieve fiscal transparency can lead to inappropriate results under certain provisions [of subpart F] of the Code.”<sup>51</sup>

As noted by the Joint Committee on Taxation, “The issuance of Notice 98-11 and the temporary and proposed regulations provoked controversy among taxpayers and members of Congress.”<sup>52</sup> On July 6, 1998, Treasury and the IRS reversed course in Notice 98-35, withdrawing Notice 98-11 and the proposed regulations issued on March 26, 1998. The agencies reversed course despite their expressed concern that the check-the-box rules had changed substantive tax law as set out in Subpart F. The result left the check-the-box loophole open, providing U.S. multinationals with the ability to shift income offshore without the threat of incurring Subpart F taxation on passive foreign income.

Because the check-the-box rule was a product of Treasury regulations and could be revoked or revised at any time, proponents of the rule urged Congress to enact supporting legislation. In 2006, Congress eliminated related party passive income generally from subpart F when it enacted Section 954(c)(6) on a temporary basis. This Section was enacted into law without significant debate as part of a larger tax bill.<sup>53</sup> It provided “look-through” treatment for certain payments between related CFCs, and became known as the CFC look-through rule. It granted an exclusion from Subpart F income for certain dividends, interest, rents and royalties received or accrued by one CFC from a related CFC. As one analyst has explained:

“*Section 954(c)(6)* came into the law somewhat quietly, through an oddly named piece of legislation (the Tax Increase Prevention and Reconciliation Act of 2005, or TIPRA, which was enacted in May 2006). *Section 954(c)(6)* had earlier passed the Senate and the House as part of the American Jobs Creation Act of 2004, but was then dropped without explanation in conference. When it reemerged one-and-a-half years later in TIPRA it did not attract huge pre-enactment attention, and when finally enacted, its retroactive effective date surprised some taxpayers.”<sup>54</sup>

The 2006 statutory look-through provision expired on December 31, 2009, but was retroactively reinstated for 2010, and extended through 2011, by the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010, enacted on December 17, 2010. It was

<sup>50</sup> 1/16/1998, IRS Notice 98-11, at 2.

<sup>51</sup> 3/26/1998 “Guidance Under Subpart F Relating to Partnerships and Branches,” 26 CFR Parts 1 and 301 [TD 8767], at 2.

<sup>52</sup> 7/20/2010 “Present Law and Background Related to Possible Income Shifting and Transfer Pricing,” Joint Committee on Taxation, (JCX-37-10), at 49.

<sup>53</sup> Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. No. 109-222, § 103(b)(1) (2006).

<sup>54</sup> 4/23/2007 “The New Look-Through [R]ule: W[h]ither Subpart F?” Tax Notes, David Sicular, at 359.

then retroactively reinstated again for 2012, and extended through December 31, 2013 by the American Taxpayer Relief Act, enacted on January 2, 2013.

In addition to the regulations and temporary statutory provisions that have undercut Subpart F's effort to tax offshore passive income, certain statutory exceptions have also weakened important provisions of the law. Two of those exceptions relevant to the Subcommittee's review of Apple are the "same country exception" and "manufacturing exception."

## **H. Foreign Personal Holding Company Income – Same Country Exception**

A major type of taxable Subpart F offshore income is referred to in the tax code as Foreign Personal Holding Company Income (FPHC).<sup>55</sup> It consists of passive income such as dividends, royalties, rents and interest.<sup>56</sup> One example of FPHC income that is taxable under Subpart F is a dividend payment made from a lower tiered to a higher tiered CFC. Another example would be a royalty payment made from one CFC to another. Under Subpart F, both types of passive income received by the CFCs are treated as taxable income in the year received for the U.S. parent.

There are several exceptions, however, to current taxation of FPHC income under Subpart F.<sup>57</sup> One significant exclusion exists for certain dividends, interest and royalties where the payor CFC is organized and operating in the same foreign country as the related CFC recipient. This exclusion is often referred to as the "same country exception." The purpose of this exception is to shield from taxation a payment from one related CFC to another in the same country, on the theory that since both CFCs are subject to the same tax regime, they would have little incentive to engage in tax transactions to dodge U.S. taxes.

## **I. Foreign Base Company Sales Income – Manufacturing Exception**

A second key type of taxable Subpart F offshore income is referred to in the tax code as Foreign Base Company Sales (FBCS) income. FBCS income generally involves a CFC which is organized in one jurisdiction, used to buy goods, typically from a manufacturer in another jurisdiction, and then sells the goods to a related CFC for use in a third jurisdiction, while retaining the income resulting from those transactions. It is meant to tax the retained profits of an intermediary CFC which typically sits in a tax haven. More specifically, FBCS income is income attributable to related-party sales of personal property made through a CFC, if the country of the CFC's incorporation is neither the origin nor the destination of the goods and the CFC itself has not "manufactured" the goods.<sup>58</sup> In other words, for the income to be considered foreign base company sales income, the personal property must be both produced outside the CFC's country of organization and distributed or sold for use outside that same country.<sup>59</sup> The

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<sup>55</sup> IRC Section 954(c).

<sup>56</sup> IRC Section 954(c).

<sup>57</sup> 7/20/2010 "Present Law and Background Related to Possible Income Shifting and Transfer Pricing," Joint Committee on Taxation, (JCX-37-10), at 36.

<sup>58</sup> IRC Section 954(a)(2).

<sup>59</sup> IRC Section 954(d)(1).

purpose of taxing FBCS income under Subpart F was to discourage multinationals from splitting the manufacturing function from the sales function to deflect sales income to a tax haven jurisdiction.

An exclusion known as the “manufacturing exception” was created, however, for certain FBCS income. Under this exception, the income retained by the intermediary CFC would not be taxed if the CFC itself were a manufacturer and added substantive value to the goods. In 2008, the regulations governing the manufacturing exception were liberalized to make it very easy for a company to claim the exception, further undermining Subpart F. The 2008 regulations provided that “[a] CFC can qualify for the manufacturing exception if it meets one of three tests. The first two [are] physical manufacturing tests: the substantial transformation test and the substantial activity test. The third test [is] the substantial contribution test.”<sup>60</sup> Moving from a requirement that the CFC demonstrate that it performed a manufacturing activity to demonstrating that it made a “substantial contribution” to the goods being sold has transformed this exception into another possible loophole to shield offshore income from Subpart F taxation.

These exceptions and loopholes, as well as other tax provisions, often form overlapping layers of protection against offshore income being taxed under Subpart F. In many instances, a multinational corporation may have multiple exceptions or loopholes available to it to dodge U.S. taxes. For example, as noted above, certain types of passive income may be excluded from Subpart F inclusion through the use of the check-the-box regulations, the look-through rule, or the same country exception. Similarly, FBCS income may be excluded through the use of the check-the-box regulations or the manufacturing exception. If one is not available or taken away, other provisions may be relied on to circumvent the original intent of Subpart F. Through the benefits of deferral and various regulatory and statutory exceptions, the tax code has created multiple incentives for multinational corporations to move income offshore to low or no tax jurisdictions and provided multiple methods to avoid current tax on those offshore transfers. The purpose of the Subcommittee’s investigation is to examine those tax loopholes and find an effective way of closing them.

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<sup>60</sup> 7/20/2010 “Present Law and Background Related to Possible Income Shifting and Transfer Pricing,” Joint Committee on Taxation, (JCX-37-10), at 38.

### **III. APPLE CASE STUDY**

#### **A. Overview**

The Apple case study examines how Apple Inc., a U.S. corporation, has used a variety of offshore structures, arrangements, and transactions to shift billions of dollars in profits away from the United States and into Ireland, where Apple has negotiated a special corporate tax rate of less than 2%. One of Apple's more unusual tactics has been to establish and direct substantial funds to offshore entities that are not declared tax residents of any jurisdiction. In 1980, Apple created Apple Operations International, which acts as its primary offshore holding company but has not declared tax residency in any jurisdiction. Despite reporting net income of \$30 billion over the four-year period 2009 to 2012, Apple Operations International paid no corporate income taxes to any national government during that period. Similarly, Apple Sales International, a second Irish affiliate, is the repository for Apple's offshore intellectual property rights and the recipient of substantial income related to Apple worldwide sales, yet claims to be a tax resident nowhere and may be causing that income to go untaxed.

In addition, this case study examines how Apple Inc. transferred the economic rights to its intellectual property through a cost sharing agreement to two offshore affiliates in Ireland. One of those affiliates, Apple Sales International, buys Apple's finished products from a manufacturer in China, re-sells them at a substantial markup to other Apple affiliates, and retains the resulting profits. Over a four-year period, from 2009 to 2012, this arrangement facilitated the shift of about \$74 billion in worldwide profits away from the United States to an offshore entity with allegedly no tax residency and which may have paid little or no income taxes to any national government on the vast bulk of those funds. Additionally, the case study shows how Apple makes use of multiple U.S. tax loopholes, including the check-the-box rules, to shield offshore income otherwise taxable under Subpart F. Those loopholes have enabled Apple, over a four year period from 2009 to 2012, to defer paying U.S. taxes on \$44 billion of offshore income, or more than \$10 billion of offshore income per year. As a result, Apple has continued to build up its offshore cash holdings which now exceed \$102 billion.

#### **B. Apple Background**

##### **1. General Information**

Apple Inc. is headquartered in Cupertino, California. It was formed as a California corporation on January 3, 1977, and has been publicly traded for more than 30 years. The current Chairman of the Board is Arthur D. Levinson, Ph.D., and the Chief Executive Officer (CEO) is Tim Cook. Apple is a personal computer and technology company specializing in the design and sale of computers, mobile telephones, and other high-technology personal goods. The sales of personal computers, mobile telephones, and related devices accounts for 95% of Apple's business, while the remaining 5% comes from the sale of related software and digital media.

The company has approximately 80,000 employees worldwide, with 52,000 of those in the United States. The U.S. jobs include 10,000 Apple advisors and 26,000 retail employees. In

2012, Apple reported in its public filings with the Securities and Exchange Commission (SEC) net income of \$41.7 billion, based upon revenues of \$156.5 billion.<sup>61</sup> These figures translate into earnings per share of \$44.15.<sup>62</sup>

Apple conducts its business geographically, with operations for North and South America, including the United States, headquartered in California, and operations for the rest of the world, including Europe, the Middle East, India, Africa, Asia, and the Pacific, headquartered in Ireland.<sup>63</sup> Apple develops its products through research and development conducted primarily in the United States; the materials and components for Apple products are sourced globally.<sup>64</sup> The finished products are typically assembled by a third party manufacturer in China and distributed throughout the world via distribution centers headquartered in the United States and Ireland.<sup>65</sup>

## 2. Apple History

Apple was founded in 1976 by Steve Jobs, Steve Wozniak, and Ronald Wayne, to design and sell personal computers.<sup>66</sup> In the late 1970s, Apple decided to expand its presence in Europe and, in the summer of 1980, established several Irish affiliates. Apple entered into a cost-sharing agreement with two of them, Apple Operations Europe (AOE) and its subsidiary, Apple Sales International (ASI).<sup>67</sup> Under the terms of the cost-sharing agreement, Apple's Irish affiliates shared Apple's research and development costs, and in exchange, were granted the economic rights to use the resulting intellectual property. At the time in 1980, Apple's Irish affiliate manufactured the products for sale in Europe.

In December 1980, Apple had its initial public offering of stock and began trading on the New York Stock Exchange.<sup>68</sup> During the 1980s and 1990s, Apple expanded its product lines. While the majority of Apple's research and development continued to be conducted in the United States, its products were manufactured in both California and Cork, Ireland.

By the late 1990s, Apple was experiencing severe financial difficulties and, in 1996 and 1997, incurred two consecutive years of billion-dollar losses. In response, Apple significantly restructured its operations, eliminating many of its product lines and streamlining its offshore operations. In addition, Apple began to outsource much of its manufacturing, using third-party manufacturers to produce the components for the products developed in its California facilities.

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<sup>61</sup> Apple Inc. Annual Report (Form-10K), at 24 (10/21/2012).

<sup>62</sup> Id.

<sup>63</sup> Subcommittee interviews of Cathy Kearney, Apple Distribution International, Vice President of European Operations (4/19/2013) and Tim Cook, Apple Inc.'s former Chief Operating Officer and current Chief Executive Officer (4/29/2013). See also Information supplied to the Subcommittee by Apple, APL-PSI-000351.

<sup>64</sup> Subcommittee interviews of Cathy Kearney (4/19/2013) and Tim Cook (4/29/2013).

<sup>65</sup> Id.

<sup>66</sup> See "30 Pivotal Moments In Apple's History," Macworld, Owen W. Linzmayer, (3/30/2006), <http://www.macworld.com/article/1050112/30moments.html>.

<sup>67</sup> Apple's first cost-sharing agreement was executed on December 1, 1980. See Information supplied to the Subcommittee by Apple, APL-PSI-000003. AOE was then named Apple Computer Ltd., and ASI was then named Apple Computer International, Inc. Id.

<sup>68</sup> Apple Inc – Frequently Asked Questions, <http://investor.apple.com/faq>.

Apple also outsourced the assembly of nearly all of its finished products to a third party manufacturer in China. Apple subsequently consolidated its financial management in five shared service centers, with the service center for the Europe region located in Cork, Ireland. It also eliminated over 150 bank accounts in foreign affiliates and established a policy of consolidating excess offshore cash in bank accounts held by its Irish affiliates.

According to Apple, it currently has about \$145 billion in cash, cash equivalents and marketable securities, of which \$102 billion is “offshore.”<sup>69</sup> As of 2011, Apple held between 75 and 100% of those offshore cash assets in accounts at U.S. financial institutions.<sup>70</sup>

### **C. Using Offshore Affiliates to Avoid U.S. Taxes**

Apple continues to organize its sales by dividing them between two regions as it has since 1980. Apple Inc. in the United States is responsible for coordinating sales for the Americas, and Apple’s Irish affiliate - Apple Sales International (ASI) is responsible for selling Apple products to Europe, the Middle East, Africa, India, Asia and the Pacific.<sup>71</sup> Apple bifurcates its economic intellectual property rights along these same lines. Apple Inc. is the sole owner of the legal rights to Apple intellectual property. Through a cost-sharing arrangement, Apple Inc. owns the economic rights to Apple’s intellectual property for goods sold in the Americas, while Apple’s Irish affiliates, Apple Sales International (ASI) and its parent, Apple Operations Europe Inc. (AOE), own the economic rights to intellectual property for goods sold in Europe, the Middle East, Africa, India, and Asia (“offshore”).<sup>72</sup> According to Apple, this cost sharing-arrangement enables Apple to produce and distribute products around the world.

Apple Inc. conducts its offshore operations through a network of offshore affiliates. The key affiliates at the top of the offshore network are companies that are incorporated in Ireland and located at the same address in Cork, Ireland. Apple’s current offshore organizational structure in Ireland is depicted in the following chart:

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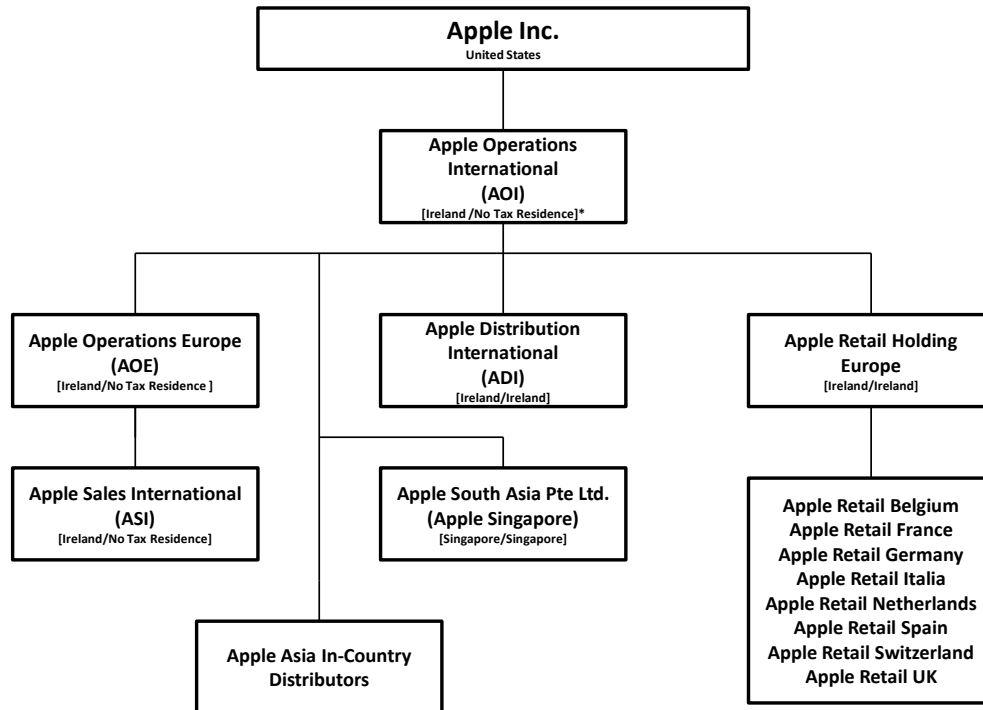
<sup>69</sup> 4/23/2013 Apple Second Quarter Earnings Call, Fiscal Year 2013, <http://www.nasdaq.com/asp/call-transcript.aspx?StoryId=1364041&Title=apple-s-ceo-discusses-f2q13-results-earnings-call-transcript>.

<sup>70</sup> U.S. Senate Permanent Subcommittee on Investigations, “Offshore Funds Located Onshore,” (12/14/2011), at 5 (an addendum to “Repatriating Offshore Funds: 2004 Tax Windfall for Select Multinationals,” S.Rpt. 112-27 (Oct. 11, 2011)).

<sup>71</sup> Information supplied to the Subcommittee by Apple, APL-PSI-000351.

<sup>72</sup> Id. See also Amended & Restated Cost Sharing Agreement between Apple Inc., Apple Operations Europe, & Apple Sales International, APL-PSI-000020 [Sealed Exhibit].

## Apple's Offshore Organizational Structure



\*Listed countries indicate country of incorporation and country of tax residence, respectively.

Prepared by the Permanent Subcommittee on Investigations, May 2013. Source: Materials received from Apple Inc.

### 1. Benefiting from A Minimal Tax Rate

A number of Apple's key offshore subsidiaries are incorporated in Ireland. A primary reason may be the unusually low corporate income tax rate provided by the Irish government. Apple told the Subcommittee that, for many years, Ireland has provided Apple affiliates with a special tax rate that is substantially below its already relatively low statutory rate of 12 percent. Apple told the Subcommittee that it had obtained this special rate through negotiations with the Irish government.<sup>73</sup> According to Apple, for the last ten years, this special corporate income tax rate has been 2 percent or less:

“Since the early 1990's, the Government of Ireland has calculated Apple's taxable income in such a way as to produce an effective rate in the low single digits .... The rate has varied from year to year, but since 2003 has been 2% or less.”<sup>74</sup>

Other information provided by Apple indicates that the Irish tax rate assessed on Apple affiliates has recently been substantially below 2%. For example, Apple told the Subcommittee that, for the three year period from 2009 to 2011, ASI paid an Irish corporate income tax rate that

<sup>73</sup> Subcommittee interview of Phillip Bullock, Apple Inc. Tax Operations Head (5/15/2013).

<sup>74</sup> Information supplied to the Subcommittee by Apple, PSI-Apple-02-0004.



was consistently below far below 1% and, in 2011, was as low as five-hundredths of one percent (0.05%):

**Global Taxes Paid by ASI, 2009-2011**

	<b>2011</b>	<b>2010</b>	<b>2009</b>	<b>Total</b>
<b>Pre-Tax Earnings</b>	\$ 22 billion	\$ 12 billion	\$ 4 billion	\$ 38 billion
<b>Global Tax</b>	\$ 10 million	\$ 7 million	\$ 4 million	\$ 21 million
<b>Tax Rate</b>	0.05%	0.06%	0.1%	0.06%

Source: Apple Consolidating Financial Statements, APL-PSI-000130-232 [Sealed Exhibit]

These figures demonstrate that Ireland has essentially functioned as a tax haven for Apple, providing it with minimal income tax rates approaching zero.

## 2. Avoiding Taxes By Not Declaring A Tax Residency

### (a) Apple Operations International (AOI)

Apple's first tier offshore affiliate, as indicated in the earlier chart, is Apple Operations International (AOI). Apple Inc. owns 100% of AOI, either directly or indirectly through other controlled foreign corporations.<sup>75</sup> AOI is a holding company that is the ultimate owner of most of Apple's offshore entities. AOI holds, for example, the shares of key entities at the second tier of the Apple offshore network, including Apple Operations Europe (AOE), Apple Distribution International (ADI), Apple South Asia Pte Ltd. (Apple Singapore), and Apple Retail Europe Holdings, which owns entities that operate Apple's retail stores throughout Europe. In addition to holding their shares, AOI serves a cash consolidation function for the second-tier entities as well as for most of the rest of Apple's offshore affiliates, receiving dividends from and making contributions to those affiliates as needed.<sup>76</sup>

AOI was incorporated in Ireland in 1980.<sup>77</sup> Apple told the Subcommittee that it is unable to locate the historical records regarding the business purpose for AOI's formation, or the purpose for its incorporating in Ireland.<sup>78</sup> While AOI shares the same mailing address as several other Apple affiliates in Cork, Ireland, AOI has no physical presence at that or any other address.<sup>79</sup> Since its inception more than thirty years earlier, AOI has not had any employees.<sup>80</sup> Instead, three individuals serve as AOI's directors and sole officer, while working for other Apple companies. Those individuals currently consist of two Apple Inc. employees, Gene Levoff and Gary Wipfler, who reside in California and serve as directors on numerous other

<sup>75</sup> Apple Inc. directly owns 97% of AOI and holds the remaining shares through two affiliates, Apple UK which owns 3% of AOI shares, and Baldwin Holdings Unlimited, a nominee shareholder formed in the British Virgin Islands, which holds a fractional share of AOI, on behalf of Apple Inc. Information supplied to the Subcommittee by Apple, APL-PSI-000236, and APL-PSI-000352.

<sup>76</sup> Subcommittee interview of Gary Wipfler, Apple Inc. Corporate Treasurer (4/22/2013).

<sup>77</sup> Information supplied to the Subcommittee by Apple, APL-PSI-000100.

<sup>78</sup> Information supplied to the Subcommittee by Apple, APL-PSI-000351.

<sup>79</sup> Subcommittee interview of Cathy Kearney (4/19/2013).

<sup>80</sup> Id.

boards of Apple offshore affiliates, and one ADI employee, Cathy Kearney, who resides in Ireland. Mr. Levoff also serves as AOI's sole officer, as indicated in the following chart:<sup>81</sup>

### Apple Operations International Officers and Directors

AOI Directors and Officer	Residence	Employer / Job Title
Gene Levoff (Director/Secretary)	USA	Apple Inc./Director of Corporate Law
Gary Wipfler (Director)	USA	Apple Inc./VP and Corporate Treasurer
Cathy Kearney (Director)	Ireland	ADI/VP of European Operations

Source: Apple Response to Subcommittee Questionnaire, APL-PSI-00235

AOI's board meetings have almost always taken place in the United States where the two California board members reside. According to minutes from those board meetings, from May of 2006 through the end of 2012, AOI held 33 board of directors meetings, 32 of which took place in Cupertino, California.<sup>82</sup> AOI's lone Irish-resident director, Ms. Kearney, participated in just 7 of those meetings, 6 by telephone. For a six-year period lasting from September 2006 to August 2012, Ms. Kearney did not participate in any of the 18 AOI board meetings. AOI board meeting notes are taken by Mr. Levoff, who works in California, and sent to the law offices of AOI's outside counsel in Ireland, which prepares the formal minutes.<sup>83</sup>

Apple told the Subcommittee that AOI's assets are managed by employees at an Apple Inc. subsidiary, Braeburn Capital, which is located in Nevada.<sup>84</sup> Apple indicated that the assets themselves are held in bank accounts in New York.<sup>85</sup> Apple also indicated that AOI's general ledger – its primary accounting record – is maintained at Apple's U.S. shared service center in Austin, Texas.<sup>86</sup> Apple indicated that no AOI bank accounts or management personnel are located in Ireland.

Because AOI was set up and continues to operate without any employees, the evidence indicates that its activities are almost entirely controlled by Apple Inc. in the United States. In fact, Apple's tax director, Phillip Bullock, told the Subcommittee that it was his opinion that AOI's functions were managed and controlled in the United States.<sup>87</sup>

In response to questions, Apple told the Subcommittee that over a four-year period, from 2009 to 2012, AOI received \$29.9 billion in dividends from lower-tiered offshore Apple

<sup>81</sup> Mr. Levoff told the Subcommittee that he serves on about 70 different boards of Apple subsidiaries. Subcommittee interview of Gene Levoff, Apple Inc. Director of Corporate Law (5/2/2013). Mr. Levoff also stated that he rarely traveled internationally to carry out his duties as a director on the boards of Apple's subsidiaries, instead carrying out his duties from the United States. *Id.*

<sup>82</sup> Summary tables of the Board of Directors meetings of AOI prepared by Apple for the Subcommittee, APL-PSI-000323, APL-PSI-000341, and APL-PSI-000349.

<sup>83</sup> Subcommittee interview of Gene Levoff (5/2/2013).

<sup>84</sup> Subcommittee interview of Gary Wipfler (4/22/2013).

<sup>85</sup> *Id.*

<sup>86</sup> Subcommittee interview of Phillip Bullock (11/28/2012).

<sup>87</sup> *Id.*

affiliates.<sup>88</sup> According to Apple, AOI's net income made up 30% of Apple's total worldwide net profits from 2009-2011,<sup>89</sup> yet Apple also disclosed to the Subcommittee that AOI did not pay any corporate income tax to any national government during that period.<sup>90</sup>

Apple explained that, although AOI has been incorporated in Ireland since 1980, it has not declared a tax residency in Ireland or any other country and so has not paid any corporate income tax to any national government in the past 5 years.<sup>91</sup> Apple has exploited a difference between Irish and U.S. tax residency rules. Ireland uses a management and control test to determine tax residency, while the United States determines tax residency based upon the entity's place of formation. Apple explained that, although AOI is incorporated in Ireland, it is not tax resident in Ireland, because AOI is neither managed nor controlled in Ireland.<sup>92</sup> Apple also maintained that, because AOI was not incorporated in the United States, AOI is not a U.S. tax resident under U.S. tax law either.

When asked whether AOI was instead managed and controlled in the United States, where the majority of its directors, assets, and records are located, Apple responded that it had not determined the answer to that question.<sup>93</sup> Apple noted in a submission to the Subcommittee: "Since its inception, Apple determined that AOI was not a tax resident of Ireland. Apple made this determination based on the application of the central management and control tests under Irish law." Further, Apple informed the Subcommittee that it does not believe that "AOI qualifies as a tax resident of any other country under the applicable local laws."<sup>94</sup>

For more than thirty years, Apple has taken the position that AOI has no tax residency, and AOI has not filed a corporate tax return in the past 5 years. Although the United States generally determines tax residency based upon the place of incorporation, a shell entity incorporated in a foreign tax jurisdiction could be disregarded for U.S. tax purposes if that entity is controlled by its parent to such a degree that the shell entity is nothing more than an instrumentality of its parent. While the IRS and the courts have shown reluctance to apply that test, disregard the corporate form, and attribute the income of one corporation to another, the facts here warrant examination.

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<sup>88</sup> Information supplied to the Subcommittee by Apple, APL-PSI-000347, APL-PSI-000219, APL-PSI-000181 and APL-PSI-000149.

<sup>89</sup> Apple Consolidating Financial Statements, APL-PSI-000130-232 [Sealed Exhibit].

<sup>90</sup> Information supplied to the Subcommittee by Apple, APL-PSI-000240.

<sup>91</sup> Id. Apple reported that, in 2007, AOI paid just under \$21,000 in tax in France, related to the sale of a building owned by AOI, and paid a withholding tax on a dividend that same year. Information supplied to the Subcommittee by Apple, APL-PSI-000246-247. Apple explained that AOI had a taxable presence in France from 1987-2007, due to its ownership of the building from which it earned rental income until the 2007 sale. Apple has not been able to identify to the Subcommittee any other tax payment by AOI to any national government since 2007.

<sup>92</sup> Information supplied to the Subcommittee by Apple, APL-PSI-000241.

<sup>93</sup> "Apple has not made a determination regarding the location of AOI's central management and control. Rather, Apple has determined that AOI is not managed and controlled in Ireland based on the application of the central management and control test under Irish law. The conclusion that AOI is not managed and controlled in Ireland does not require a determination where AOI is managed and controlled." Information supplied to the Subcommittee by Apple, APL-PSI-000242.

<sup>94</sup> Information supplied to the Subcommittee by Apple, APL-PSI-000239.

AOI is a thirty-year old company that has operated since its inception without a physical presence or its own employees. The evidence shows that AOI is active in just two countries, Ireland and the United States. Since Apple has determined that AOI is not managed or controlled in Ireland, functionally that leaves only the United States as the locus of its management and control. In addition, its management decisions and financial activities appear to be performed almost exclusively by Apple Inc. employees located in the United States for the benefit of Apple Inc. Under those circumstances, an IRS analysis would be appropriate to determine whether AOI functions as an instrumentality of its parent and whether its income should be attributed to that U.S. parent, Apple Inc.

### **(b) Apple Sales International (ASI)**

AOI is not the only Apple offshore entity that has operated without a tax residency. Apple recently disclosed to the Subcommittee that another key Apple Irish affiliate, Apple Sales International (ASI), is also not a tax resident anywhere. Apple wrote: “Like AOI, ASI is incorporated in Ireland, is not a tax resident in the US, and does not meet the requirements for tax residency in Ireland.”<sup>95</sup> ASI is exploiting the same difference between Irish and U.S. tax residency rules as AOI.

ASI is a subsidiary of Apple Operations Europe (AOE) which is, in turn, a subsidiary of AOI.<sup>96</sup> Prior to 2012, like AOI, ASI operated without any employees and carried out its activities through a U.S.-based Board of Directors.<sup>97</sup> Also like AOI, the majority of ASI’s directors were Apple Inc. employees residing in California.<sup>98</sup> Of 33 ASI board meetings from May 2006 to March 2012, all 33 took place in Cupertino, California.<sup>99</sup> In 2012, as a result of Apple’s restructuring of its Irish subsidiaries, ASI was assigned 250 employees who used to work for its parent, AOE.<sup>100</sup> Despite acquiring those new employees, ASI maintains that its management and control is located outside of Ireland and continues to claim it has no tax residency in either Ireland or the United States.

Despite its position that it is not a tax resident of Ireland, ASI has filed a corporate tax return related to its operating presence in that country.<sup>101</sup> As shown in an earlier chart, ASI has paid minimal taxes on its income. In 2011, for example, ASI paid \$10 million in global taxes on

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<sup>95</sup> Prepared statement of Apple CEO Tim Cook before U.S. Senate Permanent Subcommittee on Investigations, (5/21/2013), at page 14, footnote 8. See also Apple Consolidating Financial Statements, APL-PSI-000130-232 [Sealed Exhibit].

<sup>96</sup> AOI owns 99.99% of AOE and .001% share of ASI; AOE owns 99.99% of ASI. Baldwin Holdings Unlimited, a British Virgin Islands nominee shareholder, holds the remaining fractional share of both AOE and ASI, on behalf of Apple Inc. Information supplied to the Subcommittee by Apple, APL-PSI-000236 and APL-PSI-000352.

<sup>97</sup> Subcommittee interview of Tim Cook (4/29/2013); information supplied to the Subcommittee by Apple, APL-PSI-000104.

<sup>98</sup> Information supplied to the Subcommittee by Apple, APL-PSI-000343.

<sup>99</sup> Id.

<sup>100</sup> Subcommittee interview of Cathy Kearney (4/19/2013).

<sup>101</sup> See Information supplied to the Subcommittee by Apple, 5/19/2013 electronic communication (“From 2009 to present, ASI has not met the tax residency requirements in Ireland. However, ASI is an operating company that files an Irish corporate tax return and pays Irish corporate income tax as required by Ireland. As we indicated in our response to Question 8(c) of our July 6, 2012 submission, ASI’s location for tax purposes is Ireland because ASI files a corporate tax return in Ireland.”)

\$22 billion in income; in 2010, ASI paid \$7 million in taxes on \$12 billion in income. Those Irish tax payments are so low relative to ASI's income, they raise questions about whether ASI is declaring on its Irish tax returns the full amount of income it has received from other Apple affiliates or whether, due to its non-tax resident status in Ireland, ASI has declared only the income related to its sales to Irish customers. Over the four year period, 2009 to 2012, ASI's income, as explained below, totaled about \$74 billion, a portion of which ASI transferred via dividends to its parent, Apple Operations Europe. ASI, which claims to have no tax residence anywhere, has paid little or no taxes to any national government on that income of \$74 billion.

### **3. Helping Apple Inc. Avoid U.S. Taxes Via A Cost-Sharing Agreement**

In addition to shielding income from taxation by declining to declare a tax residency in any country, Apple Inc.'s Irish affiliates have also helped Apple avoid U.S. taxes in another way, through utilization of a cost-sharing agreement and related transfer pricing practices. Three key offshore affiliates in this effort are ASI, its parent AOE, and Apple Distributions International (ADI), each of which holds a second or third tier position in Apple's offshore structure in Ireland. All three companies are incorporated and located in Ireland, and share the same mailing address. Another key second-tier player is Apple South Asia Pte. Ltd., a company incorporated and located in Singapore (Apple Singapore). These offshore affiliates enable Apple Inc. to keep the lion's share of its worldwide sales revenues out of the United States and instead shift that sales income to Ireland, where Apple enjoys an unusually low tax rate and affiliates allegedly with no tax residency.

The key roles played by ASI and AOE stem from the fact they are parties to a research and development cost-sharing agreement with Apple Inc., which also gives them joint ownership of the economic rights to Apple's intellectual property offshore.<sup>102</sup> As of 2012, AOE had about 400 employees and conducted a small amount of manufacturing in Cork, Ireland involving a line of specialty computers for sale in Europe.<sup>103</sup> Also as of 2012, ASI moved from zero to about 250 employees who manage Apple's other manufacturing activities as well as its product-line sales.<sup>104</sup> As part of its duties, ASI contracted with Apple's third-party manufacturer in China to assemble Apple products and acted as the initial buyer of those finished goods. ASI then re-sold the finished products to ADI for sales in Europe, the Middle East, Africa, and India; and to Apple Singapore for sales in Asia and the Pacific region.<sup>105</sup> When it re-sold the finished

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<sup>102</sup> Although AOE and ASI jointly participate in the cost-sharing agreement with Apple Inc., the bulk of Apple's offshore earnings flow to ASI. Information supplied to the Subcommittee by Apple, APL-PSI-000384. For simplicity, the Subcommittee will refer to the cost-sharing agreement as between Apple Inc. and ASI, even though the true contractual relationship is between Apple Inc. and both ASI and AOE jointly.

<sup>103</sup> Prior to Apple's restructuring of its Irish affiliates in 2012, all of Apple's 2,452 Irish employees were employed by Apple Operations Europe. In 2012, Apple re-distributed those employees across 5 different Irish affiliates, with the majority now employed by ADI. Information supplied to the Subcommittee by Apple, APL-PSI-000103 and PSI-Apple-02-0002.

<sup>104</sup> Subcommittee interview of Cathy Kearney (4/19/2013).

<sup>105</sup> This description reflects Apple's current distribution arrangements, following its 2012 restructuring of its Irish operations. Prior to the restructuring, ASI contracted with the third party manufacturer, bought the finished Apple products, and then sold those finished products to several Apple retail affiliates and directly to third-party retailers and internet customers. In 2012, Apple split the manufacturing and sales functions so that ASI now arranges for the manufacturing of Apple goods, sells the goods to ADI or Apple Singapore, and ADI or Apple Singapore then

products, ASI charged the Apple affiliates a higher price than it paid for the goods and, as a result, became the recipient of substantial income, a portion of which ASI then distributed up the chain in the form of dividends to its parent, AOE. AOE, in turn, sent dividends to AOI.<sup>106</sup>

**Cost Sharing Agreement.** The cost-sharing agreement is structured as follows.<sup>107</sup> In the agreement, Apple Inc. and ASI agree to share in the development of Apple's products and to divide the resulting intellectual property economic rights. To calculate their respective costs, Apple Inc. first pools the costs of Apple's worldwide research and development efforts. Apple Inc. and ASI then each pay a portion of the pooled costs based upon the portion of product sales that occur in their respective regions. For instance, in 2011, roughly 40 percent of Apple's worldwide sales occurred in the Americas, with the remaining 60 percent occurring offshore.<sup>108</sup> That same year, Apple's worldwide research and development costs totaled \$2.4 billion.<sup>109</sup> Apple Inc. and ASI contributed to these shared expenses based on each entity's percentage of worldwide sales. Apple Inc. paid 40 percent or \$1.0 billion, while ASI paid the remaining 60 percent or \$1.4 billion.<sup>110</sup>

**Distribution Structure.** For the majority of Apple products, as mentioned earlier, ASI contracted with a third-party manufacturer in China to assemble the finished goods. The persons who actually negotiated and signed those contracts on behalf of ASI were Apple Inc. employees based in the United States, including an Apple Inc. employee serving as an ASI director.<sup>111</sup> The third-party manufacturer manufactured the goods to fill purchase orders placed by ASI.<sup>112</sup> ASI was the initial purchaser of all goods intended to be sold throughout Europe, the Middle East, Africa, India, Asia, and the Pacific region. The chart below illustrates ASI's distribution structure as of 2012.

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manage all sales. As part of this restructuring, Apple moved employees from AOE to ASI and ADI. Information supplied to the Subcommittee by Apple, APL-PSI-000103 and PSI-Apple-02-0002.

<sup>106</sup> See, e.g., 11/17/2010 Minutes of a Meeting of the Board of Directors of Apple Operations Europe, APL-PSI-000288.

<sup>107</sup> See, e.g., the most recent version of the cost-sharing agreement, 6/25/2009 Amended and Restated Agreement to Share Costs and Risks of Intangibles Development (Grandfathered Cost Sharing Arrangement), APL-PSI-000035 [Sealed Exhibit].

<sup>108</sup> Subcommittee interview of Phillip Bullock (11/28/2012).

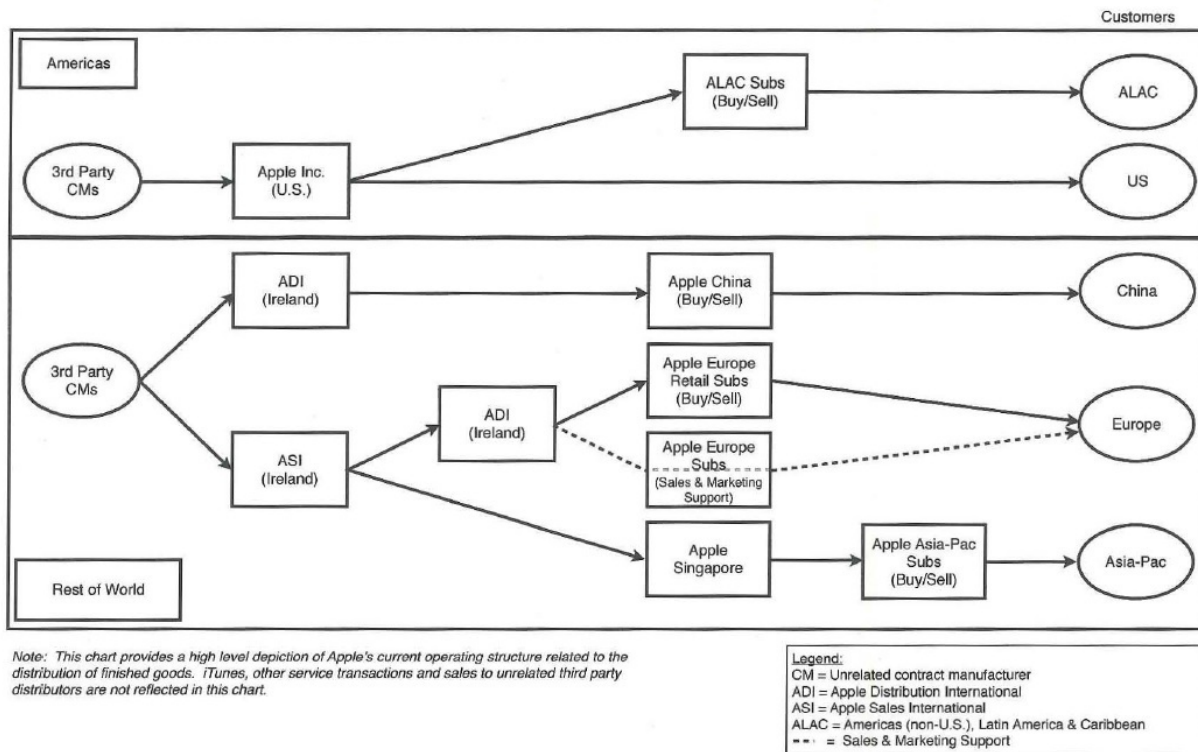
<sup>109</sup> Information supplied to the Subcommittee by Apple, APL-PSI-000129.

<sup>110</sup> Information supplied to the Subcommittee by Apple, APL-PSI-000129.

<sup>111</sup> Information supplied to the Subcommittee by Apple, APL-PSI-000392.

<sup>112</sup> Subcommittee interview of Phillip Bullock (11/28/2012).

### APPLE'S CURRENT OPERATING STRUCTURE



Source: Apple chart, prepared by Apple at the Subcommittee's request.

Once ASI took initial title of the finished goods, it resold the goods to the appropriate distribution entity, in most cases without taking physical possession of the goods in Ireland.<sup>113</sup> For sales in Europe, for example, ASI purchased the finished products from the third party manufacturer and sold them to ADI. ADI then resold the products to Apple retail subsidiaries located in various countries around Europe, to third-party resellers, or directly to internet customers. For sales in Asia and the Pacific region, ASI sold the finished goods to Apple Singapore, which then re-sold them to Apple retail subsidiaries in Hong Kong, Japan, and Australia, third party resellers, or directly to internet customers.<sup>114</sup>

Although ASI is an Irish incorporated entity and the purchaser of the goods, only a small percentage of Apple's manufactured products ever entered Ireland. Rather, title was transferred between the third party manufacturer and ASI, while the products were being directly shipped to the eventual country of sale. Upon arrival, the products were resold by ASI to the Apple distribution affiliate that took ownership of the goods. The Apple distribution affiliate then sold

<sup>113</sup> Prior to 2012, ASI also sold Apple goods directly to end customers or Apple retail entities. Subcommittee interview of Phillip Bullock (11/28/2012).

<sup>114</sup> For sales to China, the third party contract manufacturer sells the finished products to ADI, which then sells to retailers in China. To facilitate this distribution arrangement, ADI sublicenses the rights to distribute Apple products in China for a substantial sum. In FY 2012, for example, ADI paid ASI \$5.9 billion for the right to distribute in China. Information supplied to the Subcommittee by Apple, APL-PSI-000234.

the goods to either end customers or Apple retail subsidiaries.<sup>115</sup> Apple's distribution process suggests that the location of its affiliates in Ireland was not integral to the sales or distribution functions they performed. Rather, locating the entities in Ireland seemed primarily designed to facilitate the concentration of offshore profits in a low tax jurisdiction.

**Shifting Profits Offshore.** By structuring its intellectual property rights and distribution operations in the manner it did, Apple Inc. was able to avoid having worldwide Apple sales revenue related to its intellectual property attributed to itself in the United States where it would be subject to taxation in the year received. Instead, Apple Inc. arranged for a large portion of its worldwide sales revenue to be attributed to ASI in Ireland. As explained earlier, according to Apple, Ireland has provided Apple affiliates with an income tax rate of less than 2% and as low as 0.05%. In addition, given ASI's status as a non-tax resident of Ireland, it may be that ASI paid no income tax at all to any national government on the tens of billions of dollars of Apple sales income that ASI received from Apple affiliates outside of Ireland. If that is the case, Apple has been shifting its profits to its Irish subsidiary that has a tax residence nowhere, not to benefit from Ireland's minimal tax rate, but to take advantage of the disparity between Irish and U.S. tax residency rules and thereby avoid paying income taxes to any national government.

The cost-sharing agreement that Apple has signed with ASI and AOE is a key component of Apple's ability to lower its U.S. taxes. Several aspects of the cost-share agreement and Apple's research and development (R&D) and sales practices suggest that the agreement functions primarily as a conduit to shift profits offshore to avoid U.S. taxes. First, the bulk of Apple's R&D efforts, the source of the intangible value of its products, is conducted in the United States, yet under the cost sharing agreement a disproportionate amount of the resulting profits remain outside of the United States. Second, the transfer of intellectual property rights to Ireland via the cost-sharing agreement appears to play no role in the way Apple conducts its commercial operations. Finally, the cost-sharing agreement does not in reality shift any risks or benefits away from Apple, the multinational corporation; it only shifts the location of the tax liability for Apple's profits.

Almost all of Apple's research activity is conducted by Apple Inc. employees in California. The vast majority of Apple's engineers, product design specialists, and technical experts are physically located in California.<sup>116</sup> ASI and AOE employees conduct less than 1% of Apple's R&D and build only a small number of specialty computers.<sup>117</sup> In 2011, 95% of Apple's research and development was conducted in the United States,<sup>118</sup> making Apple's arrangement with ASI closer to a cost reimbursement than a co-development relationship, where both parties contribute to the intrinsic value of the intellectual property being developed.

However, despite the fact that ASI conducts only de minimis research and development activity, the cost sharing agreement gives ASI the rights to the "entrepreneurial investment"

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<sup>115</sup> Subcommittee interview of Phillip Bullock (11/28/2012). Prior to 2012, ASI sold to Apple retail subsidiaries and directly to internet customers. Since the company reorganized, ASI now sells to ADI and Apple Singapore, and those entities sell to Apple retail subsidiaries, third party resellers, or internet customers. Several Asian subsidiaries also have their own distribution entities that buy from Apple Singapore and resell in country. *Id.*

<sup>116</sup> Subcommittee interview of Phillip Bullock (5/15/2013).

<sup>117</sup> Information supplied to the Subcommittee by Apple, APL-PSI-000233.

<sup>118</sup> *Id.*



profits that result from owning the intellectual property.<sup>119</sup> According to Apple, over the four year period, 2009 to 2012, ASI made cost-sharing payments to Apple Inc. of approximately \$5 billion.<sup>120</sup> ASI's resulting income over those same 3 years was \$74 billion, a ratio of more than 15 to one, when comparing its income to its costs.<sup>121</sup> In short, ASI profited in amounts far in excess of its R&D contributions.

#### **Cost Sharing Payments and Pre-Tax Earnings of Apple Sales International (Ireland)**

	<b>Cost Sharing Payments By ASI</b>	<b>Pre-Tax Earnings of ASI</b>
2009	\$ 600 million	\$ 4 billion
2010	\$ 900 million	\$ 12 billion
2011	\$ 1.4 billion	\$ 22 billion
2012	\$ 2.0 billion	\$ 36 billion
<b>TOTAL</b>	<b>\$ 4.9 billion</b>	<b>\$ 74 billion</b>

#### **Cost Sharing Payments and Pre-Tax Earnings of Apple Inc. (United States)**

	<b>Cost Sharing Payments By Apple Inc.</b>	<b>Pre-Tax Earnings of Apple Inc.</b>
2009	\$ 700 million	\$ 3.4 billion
2010	\$ 900 million	\$ 5.3 billion
2011	\$ 1.0 billion	\$ 11 billion
2012	\$ 1.4 billion	\$ 19 billion
<b>TOTAL</b>	<b>\$ 4.0 billion</b>	<b>\$ 38.7 billion</b>

Source: Information supplied to the Subcommittee by Apple, APL-PSI-000129, 000381-384.

In comparison, over the same four years, Apple Inc. paid \$4 billion under the cost-sharing agreement and reported profits of \$29 billion.<sup>122</sup> Its cost to profits ratio was closer to 7 to one, substantially less advantageous than that of ASI. The figures disclose that Apple's Irish subsidiary, ASI, profited more than twice as much as Apple Inc. itself from the intellectual property that was largely developed in the United States by Apple Inc. personnel. That relative imbalance suggests that the cost-sharing arrangement for Apple Inc. makes little economic sense without the tax effects of directing \$74 billion in worldwide sales revenue away from the United States to Ireland, where it undergoes minimal – or perhaps – no taxation due to ASI's alleged non-tax resident status.

Second, Apple's transfer of the economic rights to its intellectual property to Ireland has no apparent commercial benefit apart from its tax effects. The company operates in numerous countries around the world, but it does not transfer intellectual property rights to each region or country where it conducts business. Instead, the transfer of economic rights is confined to Ireland alone, where the company enjoys an extremely low tax rate. When interviewed, Apple

<sup>119</sup> Subcommittee interview of Phillip Bullock (11/28/2012).

<sup>120</sup> Information supplied to the Subcommittee by Apple, APL-PSI-000129 and 000382.

<sup>121</sup> Information supplied to the Subcommittee by Apple, APL-PSI-000384. It is important to note that the cost sharing payments made by ASI have been ongoing for nearly 30 years, and that the costs and resulting profits have fluctuated over that time.

<sup>122</sup> Information supplied to the Subcommittee by Apple, APL-PSI-000129 and 000382.

officials could not adequately explain why ASI needed to acquire the economic rights to Apple's intellectual property in order for each to conduct its business. In fact, prior to Apple's reorganization in 2012, ASI had no employees. All business decisions were made by ASI's board of directors, which was composed primarily of Apple Inc. employees and held its meetings in Cupertino, California. Apple's CEO, Tim Cook, told the Subcommittee staff that, during his time as Chief Operating Officer of Apple, he was unable to recall any instance where the ownership of intellectual property rights affected Apple's business operations.<sup>123</sup>

Components used in Apple's finished goods are also produced in multiple countries around the world, without regard to where the economic rights to the underlying intellectual property are located, physically or legally. Many of the component elements of Apple's new products are designed by Apple Inc. in the United States and then manufactured by third parties from different geographic areas, including the United States. The vast majority of Apple's finished products are assembled by a third-party manufacturer in China. The Apple components are sourced globally, and the master servicing agreement governing Apple's relationship with the third-party manufacturer in China that assembles Apple's finished products is negotiated by Apple executives in California. Where this manufacturing work is performed and what entities are selected to perform that work do not appear to be driven by or restricted by which Apple entity holds the economic rights or by where those rights are located.

For example, Apple has noted that the "engine," or central processing unit (CPU), for Apple's iPhones and iPads, is the A5 series of microprocessors built in Austin, Texas. Technically, as a result of Apple's cost-sharing agreement, Apple Inc. owns all of the intellectual property rights (both legal and economic rights) embedded in the CPUs used in the Americas, and ASI owns the intellectual property economic rights for the CPUs used in rest of the world.<sup>124</sup> However, a single facility in Texas produces all of the microprocessors used in all Apple products sold around the world. No business distinction is made between microprocessors manufactured for eventual use in U.S. products, where Apple Inc. owns the intellectual property economic rights, versus use in offshore products, where ASI owns the intellectual property economic rights. In an interview with the Subcommittee, Mr. Cook noted that based on his experience as Chief Operating Officer he considered the costs of Apple components to be borne by the worldwide company rather than the economic rights holders.<sup>125</sup>

Finally, the cost-sharing agreement does not assign any costs, risks, or rewards to any third party independent of Apple. To the contrary, Apple and its offshore affiliates collectively share the risks and rewards of the corporation's research and sales activities. Although Apple Inc. and ASI are distinct legal entities, Apple executives interviewed by the Subcommittee said they viewed the "priorities and interests" of Apple's closely held entities to align with those of Apple Inc.<sup>126</sup> Apple's offshore affiliates operate as one worldwide enterprise, following a coordinated global business plan directed by Apple Inc. In fact, the last two versions of Apple's

<sup>123</sup> Subcommittee interview of Tim Cook (4/29/2013).

<sup>124</sup> Apple retains the legal rights for the rest of the world. See 6/25/2009 Amended & Restated Agreement to Share Costs and Risks of Intangibles Development (Grandfathered Cost Sharing Arrangement), APL-PSI-000020 [Sealed Exhibit].

<sup>125</sup> Subcommittee interview of Tim Cook (4/29/2013).

<sup>126</sup> Subcommittee interview of Peter Oppenheimer, Apple Inc. Chief Financial Officer (5/10/2013); Subcommittee interview of Gene Levoff (5/2/2013).

cost-sharing agreement were signed by Apple Inc. U.S.-based employees, each of whom worked for multiple Apple entities, including Apple Inc., ASI, and AOE.<sup>127</sup> Regardless of where the costs associated with the cost sharing agreement were assigned within the Apple network, or which Apple entities purchased or sold the resulting Apple products, all of the profits and losses from Apple sales were ultimately consolidated in the financial statements of Apple, Inc. The cost sharing agreement did not alter any of those arrangements in any meaningful way. The agreement primarily affects how Apple's R&D costs and sales revenues will be attributed among the affiliates of the international company and in what proportions. Apple, in every case, entered into an agreement with its own entities. In other words, the true function of the cost-sharing agreement has been, not to divide R&D costs with an outside party, but instead to afford Apple the opportunity to direct its costs and profits to affiliates in a low-tax jurisdiction.

These facts raise questions as to whether Apple's intellectual property transfers to related parties perform any function other than to shift profits and tax liability out of the United States to a low-tax jurisdiction.

#### **D. Using U.S. Tax Loopholes to Avoid U.S. Taxes on Offshore Income**

Apple's cost-sharing agreement enabled Apple Inc. to direct the lion's share of its worldwide sales income from various Apple affiliates away from the United States to its Irish affiliate, ASI, and its primary offshore holding company, AOI. Because under the U.S. tax code, that offshore income could, under certain circumstances, become subject to U.S. tax in the year received and lose its ability for those taxes to be deferred, Apple took additional steps to shield that income from U.S. taxation.

As noted above, although the United States taxes domestic corporations on their worldwide income, the U.S. tax code allows companies to defer taxes on active business income until that income is returned to the United States. To curb abuse of this foreign income deferral regime, however, Subpart F of the tax code requires that U.S. companies pay tax immediately on certain types of sales revenue transferred between CFCs and on passive foreign income such as dividends, royalties, fees, or interest payments. As explained earlier, the purpose of Subpart F is to prevent U.S. companies from shifting income to tax havens to lower their tax rate without engaging in substantive economic activity. At the same time, the effectiveness of Subpart F has

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<sup>127</sup>In 2008, Apple Inc., Apple Sales International (ASI), and Apple Operations Europe (AOE) signed an "Amended and Restated Cost Sharing Agreement." The signatory on behalf of AOE, an Irish company, was Gary Wipfler. At the time he was a Board member of both AOE and ASI and was the Treasurer of Apple Inc., in California. The signatory for Apple Inc. was Peter Oppenheimer. At the time, he was a board member ASI and AOE, as well as the Chief Financial Officer of Apple Inc. The signatory for ASI, an Irish company, was Tim Cook. At the time, he was a board member of ASI and AOE and the Chief Operating Officer of Apple Inc., in California. In other words, all three signatories to the agreement were directors or officers of all three parties involved in the contract. See Amended & Restated Cost Sharing Agreement Between Apple Inc., Apple Operations Europe & Apple Sales International, May 2008, at 15.

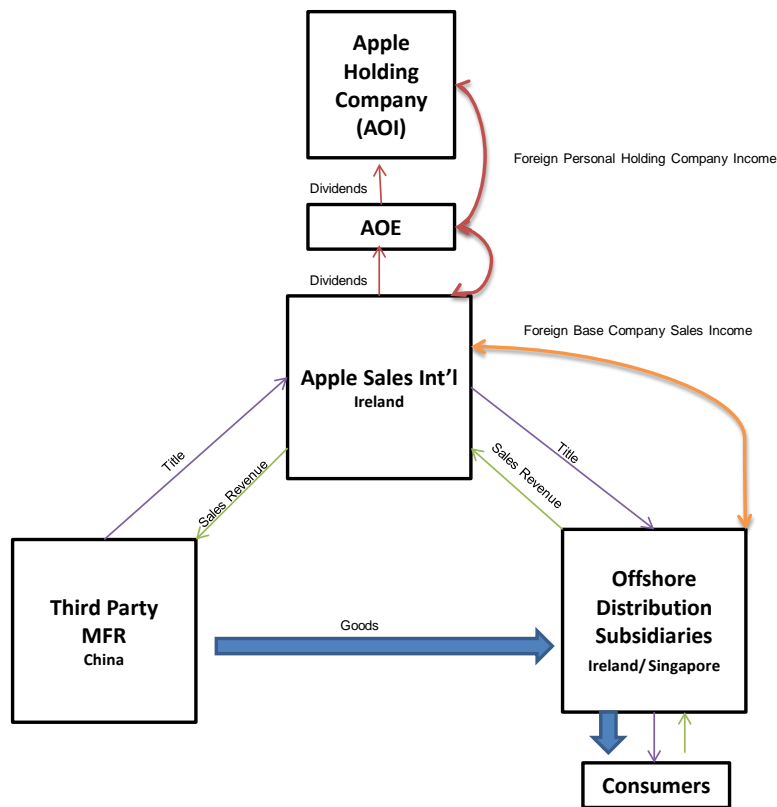
In 2009, Apple Inc., ASI and AOE entered into another Cost Sharing agreement which replaced the one signed in 2008. Mr. Oppenheimer, the CFO of Apple Inc. and a director of both ASI and AOE, was the signatory on behalf of Apple Inc. Two other Apple Inc employees signed as directors of ASI and AOE. See Amended and Restated Agreement To Share costs and Risks of Intangibles Development (Grandfathered Cost Sharing Arrangement), June 2009, at 19.

been severely weakened by certain regulations, temporary statutory changes, and statutory exemptions.

According to figures supplied by Apple, over a four year period from 2009 to 2012, as explained further below, Apple used a number of those tax loopholes to avoid Subpart F taxation of offshore income totaling \$44 billion.<sup>128</sup> During that time period, Apple generated two types of offshore income that should have been immediately taxed under Subpart F: (1) foreign base company sales (FBCS) income,<sup>129</sup> which involves the sales income Apple directed to Ireland for no reason other than to concentrate profits there, and (2) foreign personal holding company (FPHC) income,<sup>130</sup> which involves passive foreign income such as dividends, royalties, fees, and interest. Apple avoided U.S. taxation for the entire \$44 billion through a combination of regulatory and statutory tax loopholes known as the check-the-box and look-through rules.

The following chart depicts both types of income and how Apple structured its offshore operations to avoid U.S. taxes on both.

### Apple's Offshore Distribution Structure



Source: Prepared by Subcommittee based on interviews with Apple employees.

<sup>128</sup> Information supplied to the Subcommittee by Apple, APL-PSI-000386.

<sup>129</sup> IRC Section 954(d).

<sup>130</sup> IRC Section 954(c).

## 1. Foreign Base Company Sales Income: Avoiding Taxation Of Taxable Offshore Income

As explained earlier, foreign base company sales (FBCS) income rules regulate the taxation of goods sold by an entity in one country to a related entity for ultimate use in a different country. The rules were designed to prevent multinational corporations from setting up intermediary entities in tax havens for no purpose except to buy finished goods and sell them to related entities for use in another country in order to concentrate profits from the sales revenue in the tax havens. The distribution structure used by Apple's Irish entities generated significant taxable FBCS income, leading Apple to employ a web of disregarded entities to avoid those U.S. taxes.

The FBCS income designation applies to: (1) purchases of personal property manufactured (by a person other than the CFC) in a jurisdiction other than the country in which the CFC is located, and (2) sold to a related party for use outside of the jurisdiction in which the CFC is located. In the case of Apple, ASI purchased finished Apple goods manufactured in China and immediately resold them to ADI or Apple Singapore which, in turn, sold the goods around the world. ASI did not conduct any of the manufacturing – and added nothing – in Ireland to the finished Apple products it bought, yet booked a substantial profit in Ireland when it resold those products to related parties such as ADI or Apple Singapore.

In fact, ASI never took physical possession of the products it ordered from the third party manufacturer. Transfer was made in title only while the products were being shipped to the country of sale.<sup>131</sup> For example, Apple products sold in Asia were not shipped to Ireland from the third-party manufacturer and then shipped back to Asia for sale. Rather, ASI took title to the manufactured products while they were being shipped to Apple's Asian distribution centers.<sup>132</sup> When they arrived, ASI sold the products to Apple Singapore at a substantial profit.<sup>133</sup> Apple Singapore then resold the products, in turn, to Apple retail entities or end customers.<sup>134</sup> In other instances, the Apple products were shipped directly from the third-party manufacturer to end customers without any Apple intermediary taking prior physical possession.<sup>135</sup>

Transferring title in this manner allowed Apple to retain most of its profits in Ireland, where it has negotiated a favorable tax rate and maintains entities claiming to have no tax residence in any country, and limit the income it reported in the non-tax haven countries where

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<sup>131</sup> Subcommittee interview of Cathy Kearney (4/19/13).

<sup>132</sup> Subcommittee interview of Phillip Bullock (11/28/12).

<sup>133</sup> The goods were not necessarily shipped to Singapore either, but may have been shipped to a wide variety of Apple retail entities or end customers across Asia and the Pacific region. Subcommittee interview of Cathy Kearney (4/19/13).

<sup>134</sup> This example is accurate under Apple's current organizational structure. However, Apple Singapore only became an active participant in Apple's distribution channel after Apple's 2012 reorganization. Prior to that reorganization, the same basic structure applied to Apple's distribution channels. At that time, ASI purchased products from the third-party manufacturer and then sold them to Apple affiliates that owned Apple retail stores around the globe. For example, ASI purchase the finished goods from the manufacturer in China and then resold them to an Apple retail store in Australia, with ASI taking ownership of the products while in transit to Australia, then reselling them at a substantial profit to the Apple retail entity upon arrival.

<sup>135</sup> Subcommittee interview of Cathy Kearney (4/19/13).

the company did most of its business. For example, in 2011, Apple reported \$34 billion in income before taxes; however, just \$150 million of those profits, a fraction of one percent, were recorded for Apple's Japanese subsidiaries, even though Japan is one of Apple's strongest foreign markets.<sup>136</sup> ASI, meanwhile, reported \$22 billion in 2011 net income.<sup>137</sup> Those figures indicate that Apple's Japanese profits were being shifted away from the United States to Ireland, where Apple had negotiated a minimal tax rate and maintained two non-tax resident corporations.

It is this type of transfer of worldwide sales income to a tax haven subsidiary that the FBCS income provisions were designed to tax, because they do not contribute to the manufacturing or sales processes, but serve only to concentrate profits in a low tax jurisdiction. Under Subpart F, ASI's income should have been treated as FBCS income subject to U.S. taxation in the year received. Rather than declare that income, however, Apple used the check-the-box loophole to avoid all U.S. taxation of that FBCS income. When asked to calculate the total amount of U.S. taxes on FBCS income that Apple Inc. was able to avoid by using the check-the-box loophole, Apple provided the following estimates:

**Estimated U.S. Taxes Avoided by Apple Inc. Using Check The Box  
2001-2012**

	<b>Foreign Base Company Sales Income</b>	<b>Tax Avoided</b>	<b>Tax Avoided Per Day</b>
2011	\$ 10 billion	\$ 3.5 billion	\$ 10 million
2012	\$ 25 billion	\$ 9.0 billion	\$ 25 million
<b>Total</b>	<b>\$ 35 billion</b>	<b>\$ 12.5 billion</b>	<b>\$ 17 million</b>

Source: Information supplied to the Subcommittee by Apple, APL-PSI-000386.

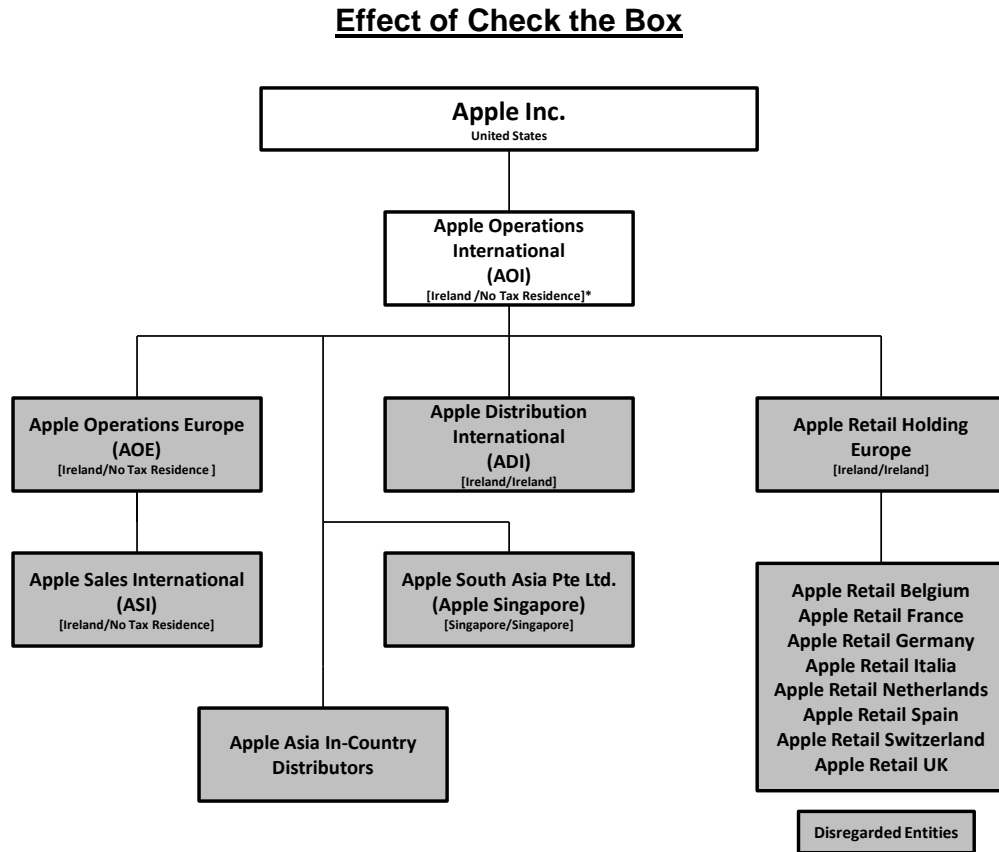
These figures indicate that, in two years alone, from 2011 to 2012, Apple Inc. used the check-the-box loophole to avoid paying \$12.5 billion in U.S. taxes or about \$17 million per day.

<sup>136</sup> Apple Consolidating Financial Statements, APL-PSI-000130-232 [Sealed Exhibit].

<sup>137</sup> Id., at APL-PSI-000219.

## 2. Using Check-the-Box to Make Transactions Disappear

To understand how Apple used the check-the-box loophole to avoid those billions of dollars in U.S. tax liability for ASI income, it helps to review Apple's offshore structure as indicated in this chart:



\*Listed countries indicate country of incorporation and country of tax residence, respectively.

Prepared by the Permanent Subcommittee on Investigations, May 2013. Source: Materials received from Apple Inc.

Under the IRS check-the-box regulations, a U.S. multinational can elect to have lower-tier foreign subsidiaries “disregarded” by the IRS as separate legal entities and instead treated as part of an upper-tier subsidiary for tax purposes. If that election is made, transactions involving the disregarded entities disappear for tax purposes, because U.S. tax regulations do not recognize payments made within the confines of a single entity.

In the Apple case, after Apple Inc. makes its check-the-box election, the bottom three tiers of its offshore network – which include AOE, ASI, ADI, Apple Singapore, Apple Retail Holding, and the Apple Retail subsidiaries – all become disregarded subsidiaries of AOI. Those companies are then treated, for U.S. tax purposes, as part of, or merged into, AOI the first tier subsidiary. As a result, the transactions between those disregarded entities are not recognized by the IRS, because the transactions are viewed as if they were conducted within the confines of the same company. The result is that the IRS sees only AOI and treats AOI as having received sales income directly from the end customers who purchased Apple products; that type of active

business income is not taxable under Subpart F. The sales income produced when ASI sold Apple products to ADI, Apple Singapore, or Apple’s Retail Entities at a substantial markup is no longer considered sales income for tax purposes – it is as if no intercompany sales happened at all. Since no intercompany sales occurred, Subpart F’s FBSC income rules no longer applies, which allowed Apple to avoid paying taxes on nearly \$44 billion in income from 2009-2012.<sup>138</sup>

### **3. Using Check-the-Box to Convert Passive Income to Active Income**

Apple also uses the check-the-box regulations to avoid U.S. taxation of a second type of offshore income. When an offshore subsidiary of a multinational corporation receives dividends, royalties or other fees from a related subsidiary, that income is considered foreign personal holding company (FPHC) income. That passive income, as it is commonly known, is normally subject to immediate taxation under Section 954(c) of Subpart F. However, once again, under check-the-box rules, if a U.S. multinational elects to have lower-tier subsidiaries “disregarded” – i.e., no longer considered as separate entities – and instead treated as part of an upper-tier subsidiary for tax purposes, any passive income paid by the lower-tier subsidiary to the higher-tier parent would essentially disappear. Because those dividends, royalties and fee payments would be treated as occurring within a single entity, the IRS would not treat them as payments between two legally separate entities or as taxable income under Subpart F.

In Apple’s case, in 2011 alone, AOI in Ireland received \$6.4 billion in dividends from lower-tier offshore affiliates. Over a four year period, from 2009 to 2012, Apple reported that AOI received a total of \$29.9 billion in income, almost exclusively from dividends issued to it by lower-tier CFCs.<sup>139</sup> That dividend income is exactly the type of passive income that Subpart F intended to be immediately taxable. However, by invoking the check-the-box regulations, Apple Inc. was able to designate the lower-tier CFCs as “disregarded entities,” requiring the IRS to view them for tax purposes as part of AOI. Once they became part of AOI, their dividend payments became payments internal to AOI and were no longer taxable passive income.

The check-the-box regulations were never intended to be used to convert taxable, offshore, passive income into nontaxable income. Nevertheless, they do, and the resulting loopholes are utilized by Apple and other U.S. multinationals. As explained earlier, the look-through rule provides a similar statutory basis for U.S. multinationals to shield passive offshore income from U.S. taxes. Despite the billions of dollars in offshore income that is escaping U.S. taxation, neither Congress nor the IRS has yet taken any effective action to close these loopholes.

### **4. Other Tax Loopholes**

Even though Apple relies primarily on the check-the-box rules to shield its offshore income from U.S. taxes, if that regulation as well as the look-through rule were eliminated, two other tax loopholes may be available to Apple to continue to avoid Subpart F taxation. They are known as the same country exception and the manufacturing exception.

<sup>138</sup> Information supplied to the Subcommittee by Apple, APL-PSI-000386.

<sup>139</sup> Information supplied to the Subcommittee by Apple, APL-PSI-000347, APL-PSI-000219, APL-PSI-000181 and APL-PSI-000149.



**Same Country Exception.** The first loophole is the same country exception.<sup>140</sup> This exception to Subpart F allows payments made between related parties organized and operating within the same country to escape taxation. This exception was created to address the situation in which related entities are located in the same jurisdiction, are theoretically subject to the same tax rate, and supposedly have less incentive to engage in tax-motivated transactions.

Many of the dividends paid to AOI originate from other Apple affiliates incorporated and operating within Ireland, such as AOE and ASI. Under the same country exception, even if the check-the-box and the look-through rules were abolished, the dividend payments made by AOE and ASI to AOI would escape taxation under Subpart F, since the companies are all organized and operating within Ireland. Ironically, because the rule is drafted in terms of the country under whose laws a company is organized, Apple could take advantage of this exception even though it claims AOI, an Irish organized company, is not tax resident in Ireland or anywhere else in the world. Under the explicit terms of the exception, Apple may be able to avail itself of the exception and eliminate all tax liability for intra-country transfers, despite the fact that, according to Apple, AOI and ASI are not tax resident in the same jurisdiction.

**Manufacturing Exception.** The second loophole is the manufacturing exception to FBCS income.<sup>141</sup> FBCS income is income attributable to related-party sales of personal property made through a CFC if the country of the CFC's incorporation is neither the origin nor the destination of the goods and the CFC itself has not "manufactured" the goods. Under Subpart F, FBCS income is currently taxable. However, under the manufacturing exception, the income from related party purchases and sales will not be characterized as FBCS income if the goods are sold to a related party that transforms or adds substantive value to the goods. In 2008, the regulations governing the manufacturing exception were liberalized to make it very easy for a company to claim such an exception.

Apple told the Subcommittee that it has made no determination about whether the company's supervision of third-party manufacturers qualifies it for the manufacturing exception to FBCS income taxation, since the company relies on the check-the-box rules. However, according to experts consulted by the Subcommittee, the low threshold of the new manufacturing exception rules makes it easy to meet the exception requirements and could be used to avoid taxation.

## **E. Apple's Effective Tax Rate**

When confronted with evidence of actions taken by the company to shield billions of dollars in offshore income from U.S. taxation – including by claiming its offshore Irish subsidiaries, AOI and ASI, have no tax residence in any country and by using the check-the-box and look-through rules to shield its offshore income from taxation – one of Apple's responses has been to claim that it already pays substantial U.S. tax.<sup>142</sup> Apple's public filings to investors cite an effective tax rate of between 24 and 32 percent. The Subcommittee's

<sup>140</sup> IRC Section 954(d)(1)(A); Reg. §1.954-3(a)(2).

<sup>141</sup> IRC Section 954(d)(1)(A).

<sup>142</sup> See, e.g., Anna Palmer, *Apple Target of Senate Hearing on Offshore Taxes*, Politico, May, 15, 2013, <http://www.politico.com/story/2013/05/apple-hearing-offshore-tax-91425.html>.

investigation has determined, however, that Apple has actually paid billions less to the government than the tax liability reported to investors.

From 2009 to 2012, in its annual report to investors, Apple claimed effective tax rates of between 24% and 32%.<sup>143</sup> In 2011, for example, Apple's annual report (Form 10-K) stated that its net income before taxes was \$34.2 billion and that its provision for the payment of corporate income taxes – the company's tax liability – was \$8.2 billion, resulting in an effective tax of 24.2%.<sup>144</sup> Apple's calculation, however, included not just its U.S. income taxes, but state and foreign taxes as well. A breakdown of its figures shows that, by its own admission, its effective tax rate for U.S. corporate income taxes was 20.1%, a third lower than the federal statutory rate of 35 percent.

The table below shows Apple's stated provision for income taxes in 2011, broken out by its U.S. federal tax liability, U.S. state-level tax liability, and foreign tax liability<sup>145</sup> as follows:

### Apple's Provision for Income Tax in its 2011 Annual Report

	<b>2011 Tax Provision (in millions of dollars)</b>	<b>Effective Tax Rate</b>
<b>Federal tax liability:</b>		
Current	\$ 3,884	
Deferred	\$ 2,998	
	<b>\$ 6,882</b>	<b>20.1%</b>
<b>State tax liability:</b>		
Current	\$ 762	
Deferred	\$ 37	
	<b>\$ 799</b>	<b>2.3%</b>
<b>Foreign tax liability:</b>		
Current	\$ 769	
Deferred	(\$ 167)	
	<b>\$ 602</b>	<b>1.8%</b>
<b>Provision for Income Taxes</b>	<b>\$ 8,283</b>	<b>24.2%</b>

Source: Apple Inc. Annual Report (Form 10-K), at 62 (10/26/2011).

Apple calculates its effective tax rate in accordance with GAAP using information in its publicly available annual reports. If the focus, however, were to turn to Apple's federal tax returns and the taxes Apple actually paid to the U.S. treasury each year, its tax payments fall substantially. As part of its investigation, the Subcommittee asked Apple to report the corporate

<sup>143</sup> Apple Inc. Annual Report (Form-10K), at 61 (10/21/2012).

<sup>144</sup> Apple Inc. Annual Report (Form 10-K), at 62 (10/26/2011).

<sup>145</sup> Apple reported an overall tax rate of 24.2%, which is larger than its three component tax rates of 20%, 2.3%, and 1.8%. The larger total is due to U.S. Generally Accepted Accounting Principles (GAAP) which require Apple to include in its "Provision for Income Taxes" all funds it has set aside to pay future taxes, even though Apple continues to retain those funds and has not actually paid those amounts to any tax authority.

income taxes it actually paid to the U.S. treasury over a three-year period, from 2009 to 2011. According to Apple, the company actually paid just \$2.4 billion in federal taxes in 2011, which is \$1.4 billion or 30 percent less than the current federal tax provision and \$4.4 billion less than the total tax provision included in the company's 2011 annual statement.<sup>146</sup>

While legitimate reasons may exist for differences between a corporation's financial statements and its tax returns, the Subcommittee found large and growing differences in each of the three years it examined with respect to Apple. In all three years, Apple reported much higher provisions for tax on its annual report than it did on its federal tax return for the same year. Moreover, the differences widened substantially over the three-year period, expanding from a 2009 difference of \$1.4 billion to a 2011 difference of \$4.4 billion. The following chart summarizes that information:

**U.S. Tax Liability Reported by Apple Inc. in its Annual Report  
versus Federal Tax Return, 2009-2011**

<b>Form (in millions of dollars)</b>	<b>FY2009</b>	<b>FY2010</b>	<b>FY2011</b>
Total Federal Tax Provision (current plus deferred) reported on 10-K annual report filed with SEC	\$ 3.0 billion	\$ 3.8 billion	\$ 6.9 billion
U.S. tax reported paid on Form 1120 tax return filed with the IRS	\$ 1.6 billion	\$ 1.2 billion	\$ 2.5 billion
<b>Difference:</b>	\$ 1.4 billion	\$ 2.6 billion	\$ 4.4 billion

Source: Information supplied to the Subcommittee by Apple, APL-PSI-000082; Apple Inc. Form 10-K for the fiscal year ended September 29, 2011, at 63.

Tax payments of \$1.6 billion, \$1.2 billion, or even \$2.5 billion produce effective tax rates well below the statutory tax rate. In that, Apple is far from alone. Recent studies indicate that, over a three-year period, from 2008 to 2010, U.S. corporations paid effective tax rates ranging from 12 to 18 percent.<sup>147</sup> One recent study found that 30 large corporations paid no tax at all during a three year period, 2008 to 2010.<sup>148</sup> U.S. records indicate that, in 2011, U.S. corporations collectively paid about \$181 billion in federal taxes, compared to the \$819 billion in

<sup>146</sup> Information supplied to the Subcommittee by Apple referencing data taken from Apple's Form 1120 U.S. Corporation Income Tax Return, APL-PSI-000082. According to Apple's 2011 10-K, the company had net excess tax benefits from stock based compensation which is the main reason for the difference between Apple's current tax liability on its financial statement and the liability reported on Apple's tax return. See Apple Inc. Form 10-K for the fiscal year ended September 29, 2011, at 63; Subcommittee interview of Phillip Bullock (5/15/2013).

<sup>147</sup> See, e.g., 1/31/2012 "The Budget and Economic Outlook, Fiscal Years: 2012 to 2022," Congressional Budget Office, at 89, [http://www.cbo.gov/sites/default/files/cbofiles/attachments/01-31-2012\\_Outlook.pdf](http://www.cbo.gov/sites/default/files/cbofiles/attachments/01-31-2012_Outlook.pdf) (finding total corporate federal taxes paid fell to 12.1% of profits earned from activities within the United States in FY2011); "Corporate Taxpayers and Corporate Tax Dodgers, 2008-2010," Citizens for Tax Justice and the Institute on Taxation and Economic Policy (11/3/2011), <http://www.ctj.org/corporatetaxdodgers/CorporateTaxDodgersReport.pdf>.

<sup>148</sup> "Corporate Taxpayers and Corporate Tax Dodgers, 2008-2010," Citizens for Tax Justice and the Institute on Taxation and Economic Policy (11/3/2011), <http://www.ctj.org/corporatetaxdodgers/CorporateTaxDodgersReport.pdf>.

payroll taxes and \$1.1 trillion in individual income taxes.<sup>149</sup> Closing offshore tax loopholes such as those created by the check-the-box and look-through rules, the same country exception, and the manufacturing exception, as well as putting a stop to corporations that deny tax residence in any jurisdiction, would help ensure that U.S. multinational corporations begin to pay their share.

The benefits of offshore tax deferral are enhanced by the fact that Apple is able to direct its offshore earnings to jurisdictions with low tax rates. As explained earlier, Apple consolidates as much of its offshore earnings as possible in Ireland, where Apple has an Irish tax rate of less than 2%.<sup>150</sup> Furthermore, Apple's ability to avoid Subpart F taxation through vehicles like check-the-box enables the company to not only shift profits out of the United States, but to shift profits out of other developed countries as well. In 2011, for example, Apple's ability to pass title to the goods it sells around the world through Ireland resulted in 84% of Apple's non-U.S. operating income being booked in ASI.<sup>151</sup> This left very small earnings, and correspondingly small tax liabilities, in countries around the world. In 2011, for example, only \$155 million in earnings before taxes were recorded in Apple's UK affiliates. Apple also had no tax liability in its French and German retail affiliates that same year. Through this foreign profit shifting, Apple is able to reduce its foreign tax rate to below 2%.<sup>152</sup> The ability to pay taxes of less than 2% on all of Apple's offshore income gives the company a powerful financial incentive to engage in convoluted tax planning to avoid paying U.S. taxes. Congress can change those incentives by closing offshore tax loopholes and strengthening U.S. tax law.

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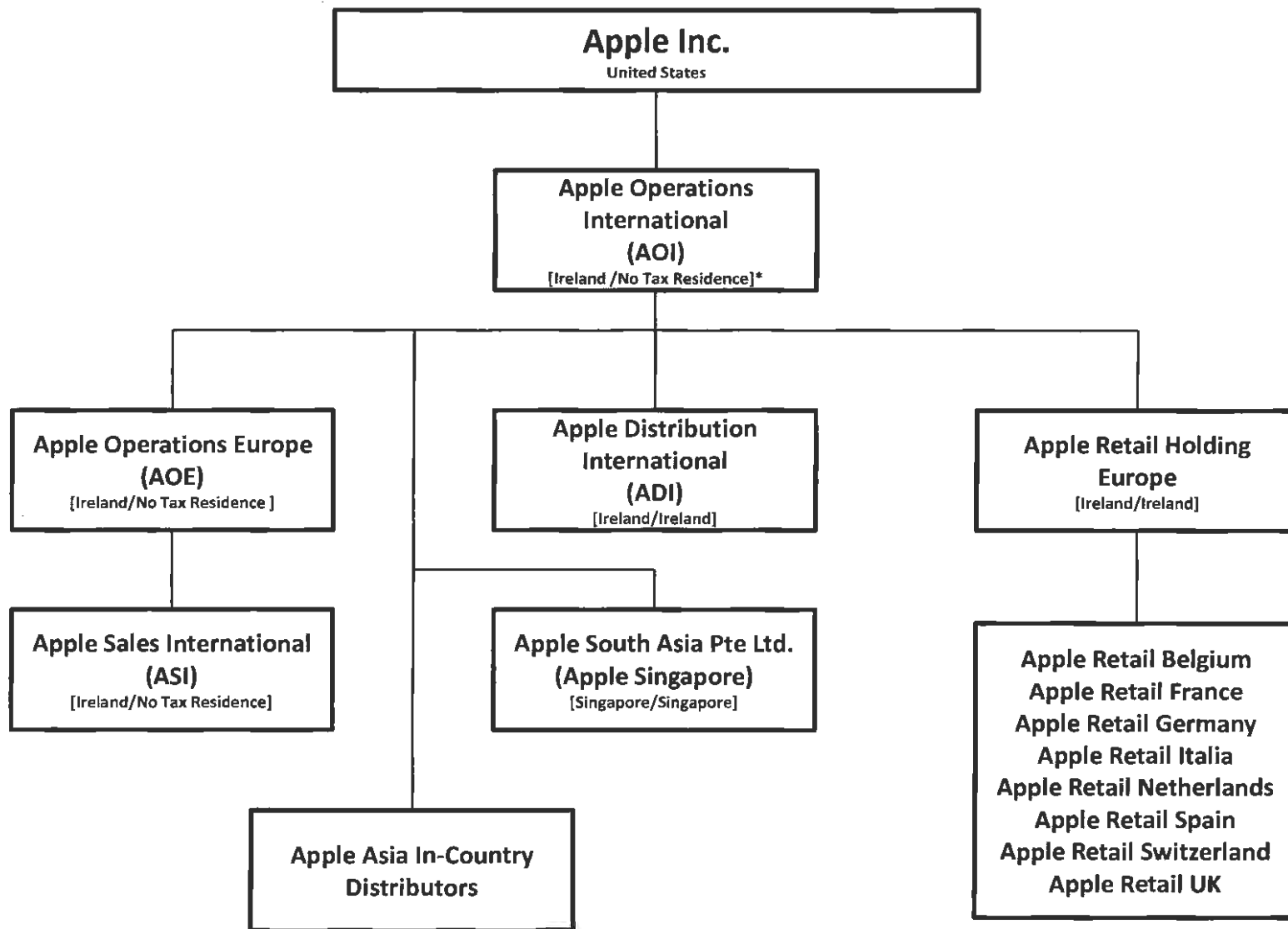
<sup>149</sup> OMB, Historical Tables, Budget of the U.S. Government, FY2001 (April 2012).

<sup>150</sup> Information supplied to the Subcommittee by Apple, PSI-Apple-02-0004.

<sup>151</sup> ASI's operating income was \$18 billion in 2011. Apple Consolidating Financial Statements, APL-PSI-000219 [Sealed Exhibit].

<sup>152</sup> According to Apple, in FY2011, its foreign tax rate was 1.8%. See Apple Inc. Annual Report (Form 10-K), at 62 (Oct. 26, 2011).

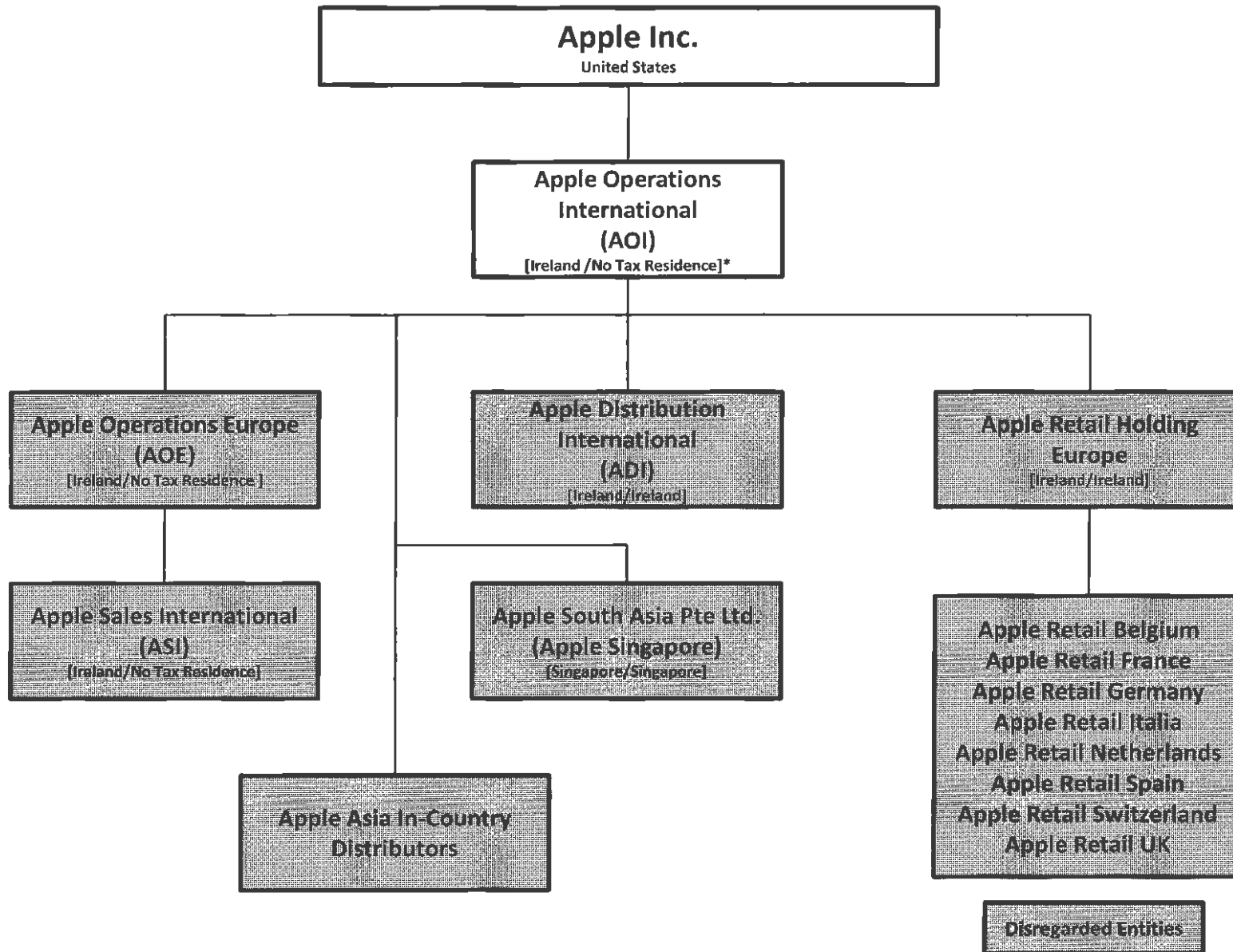
# Apple's Offshore Organizational Structure



\*Listed countries indicate country of incorporation and country of tax residence, respectively.

Permanent Subcommittee on Investigations  
**EXHIBIT #1b**

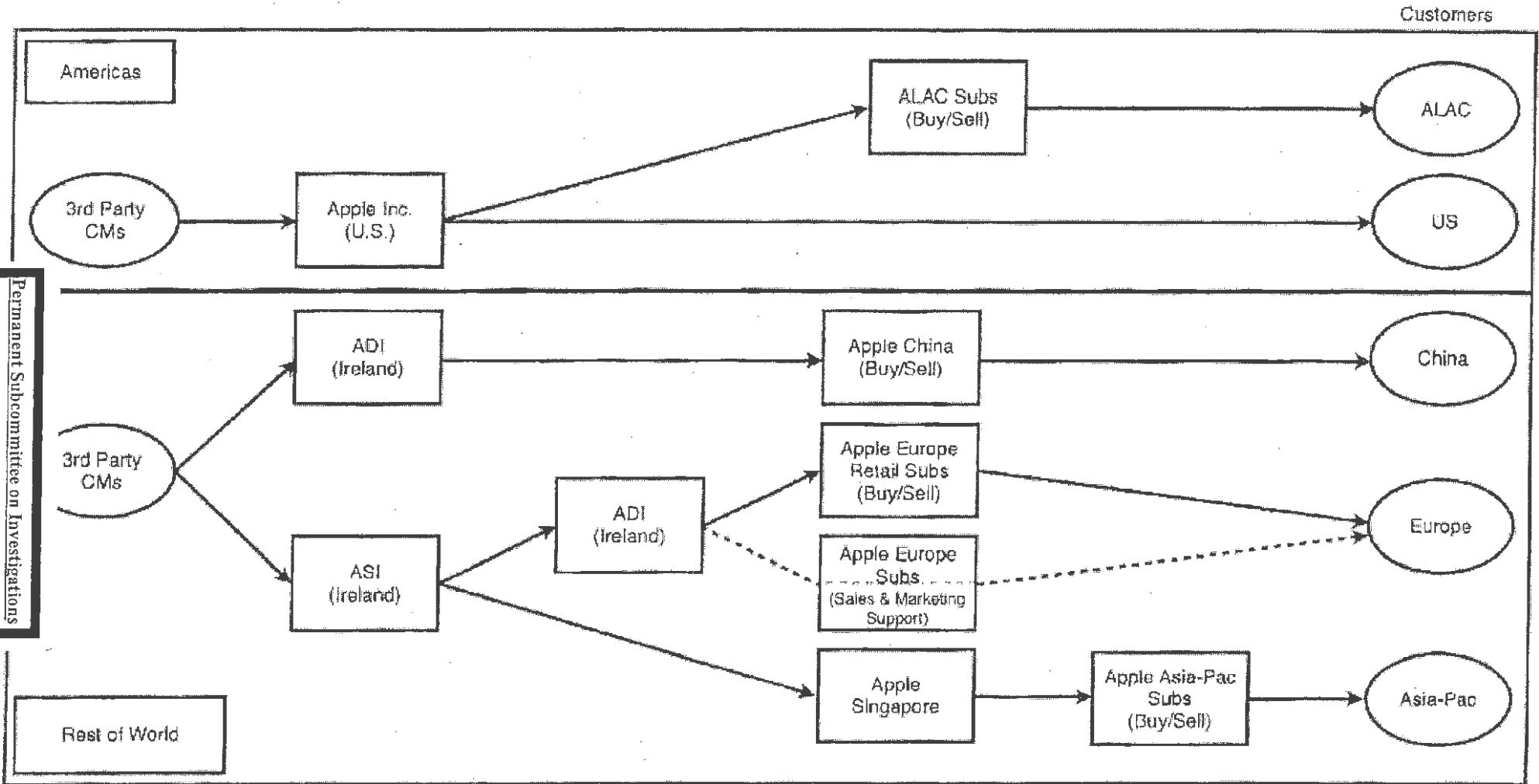
# Effect of Check the Box



Permanent Subcommittee on Investigations  
**EXHIBIT #1c**

\*Listed countries indicate country of incorporation and country of tax residence, respectively.

# APPLE'S CURRENT OPERATING STRUCTURE



Permanent Subcommittee on Investigations  
EXHIBIT #1D

*Note: This chart provides a high level depiction of Apple's current operating structure related to the distribution of finished goods. iTunes, other service transactions and sales to unrelated third party distributors are not reflected in this chart.*

Source: Apple Inc.

**Legend:**  
 CM = Unrelated contract manufacturer  
 ADI = Apple Distribution International  
 ASI = Apple Sales International  
 ALAC = Americas (non-U.S.), Latin America & Caribbean  
 - - - = Sales & Marketing Support

### Cost Sharing Payments and Earnings of Apple Sales International (Ireland)

	Cost Sharing Payments By ASI	Earnings of ASI
2009	\$ 600 million	\$ 4 billion
2010	\$ 900 million	\$ 12 billion
2011	\$ 1.4 billion	\$ 22 billion
2012	\$ 2.0 billion	\$ 36 billion
<b>TOTAL</b>	<b>\$ 4.9 billion</b>	<b>\$ 74 billion</b>

### Cost Sharing Payments and Earnings of Apple Inc. (United States)

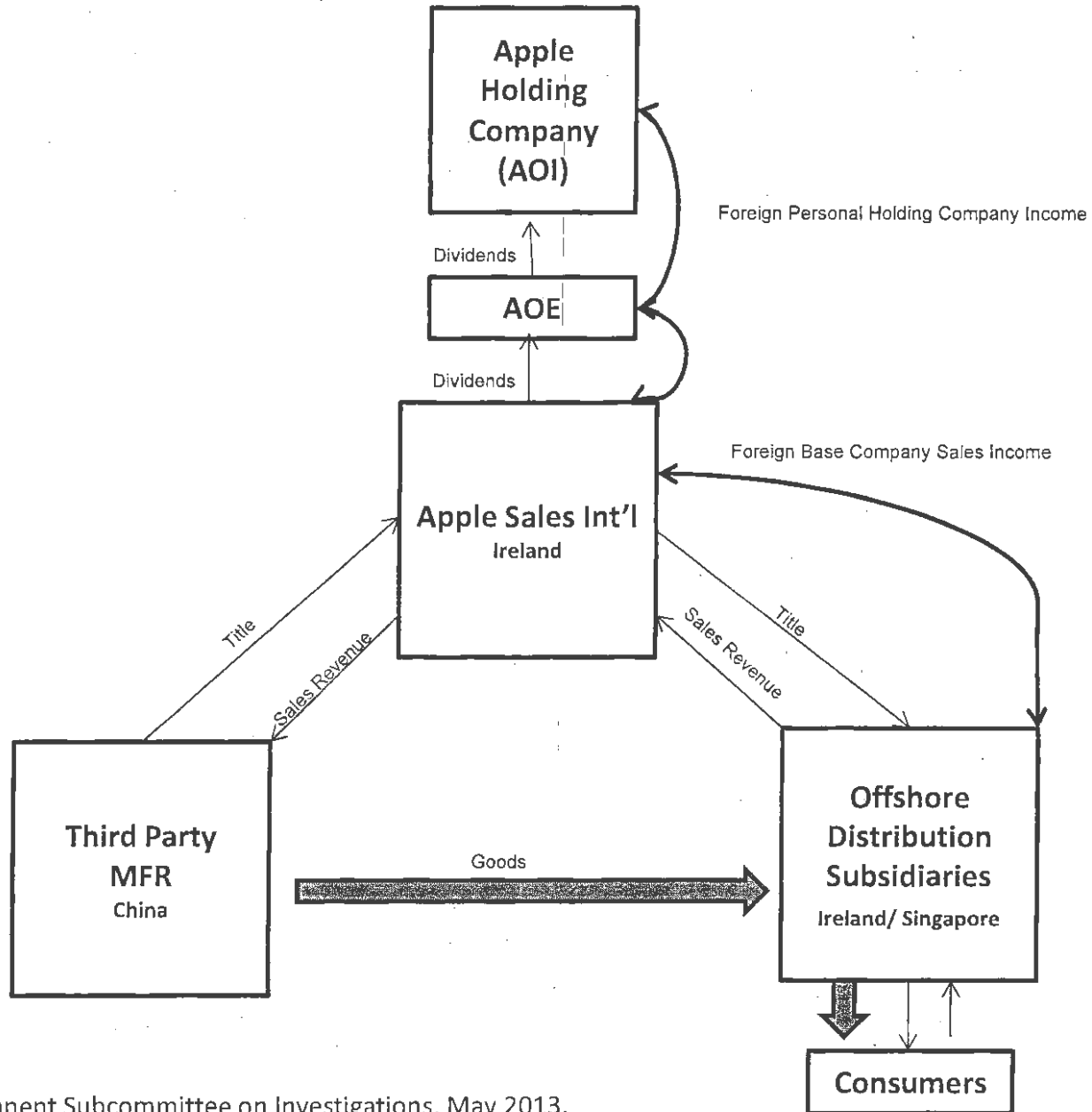
	Cost Sharing Payments By Apple Inc.	Earnings of Apple Inc.
2009	\$ 700 million	\$ 3.4 billion
2010	\$ 900 million	\$ 5.3 billion
2011	\$ 1.0 billion	\$ 11 billion
2012	\$ 1.4 billion	\$ 19 billion
<b>TOTAL</b>	<b>\$ 4.0 billion</b>	<b>\$ 38.7 billion</b>

Prepared by the Permanent Subcommittee on Investigations, May 2013.

Source: Information supplied to the Subcommittee by Apple, APL-PSI-000129, 000381-384.



# Apple's Offshore Distribution Structure



Permanent Subcommittee on Investigations  
**EXHIBIT #1f**

## Global Distribution of Apple's Earnings

Country	2011 Pre-Tax Income		2010 Pre-Tax Income		2009 Pre-Tax Income	
	\$ billions	%	\$ billions	%	\$ billions	%
Apple Inc.	\$ 10.7	31	\$ 5.3	29	\$ 3.4	43
Apple Sales International	\$ 22.0	64	\$ 12.1	65	\$ 4	50
Other	\$ 1.5	5*	\$ 1.1	6	\$ 0.6	7*
<b>Total</b>	<b>\$ 34.2</b>	<b>100</b>	<b>\$ 18.5</b>	<b>100</b>	<b>\$ 8</b>	<b>100</b>

Source: Consolidating Financial Information supplied by Apple to the Subcommittee.

\*Figure calculated based on Apple Inc. & ASI rounded results.

## Apple Operations International's Profits as a Share of Worldwide Profits

	Apple Operations International	Worldwide
2012	\$ 15.4 billion	\$ 42 billion
2011	\$ 6.3 billion	\$ 26 billion
2010	\$ 8.1 billion	\$ 14 billion
2009	\$ 110 million	\$ 6 billion
<b>Total</b>	<b>\$ 29.9 billion</b>	<b>\$ 88 billion</b>
<b>AOI's share of Worldwide Income:</b>		<b>34%</b>

Source: Information provided to the Subcommittee by Apple, APL-PSI-000386.

## Global Taxes Paid by Apple Sales International 2009-2011

	2011	2010	2009	Total
Pre-Tax Earnings	\$ 22 billion	\$ 12 billion	\$ 4 billion	\$ 38 billion
Global Tax	\$ 10 million	\$ 7 million	\$ 4 million	\$ 21 million
Tax Rate	0.05%	0.06%	0.1%	0.06%

Source: Information provided to the Subcommittee by Apple.

Permanent Subcommittee on Investigations  
**EXHIBIT #11**

Prepared by the Permanent Subcommittee on Investigations, May 2013.

## Taxes Avoided by Apple Using Check The Box

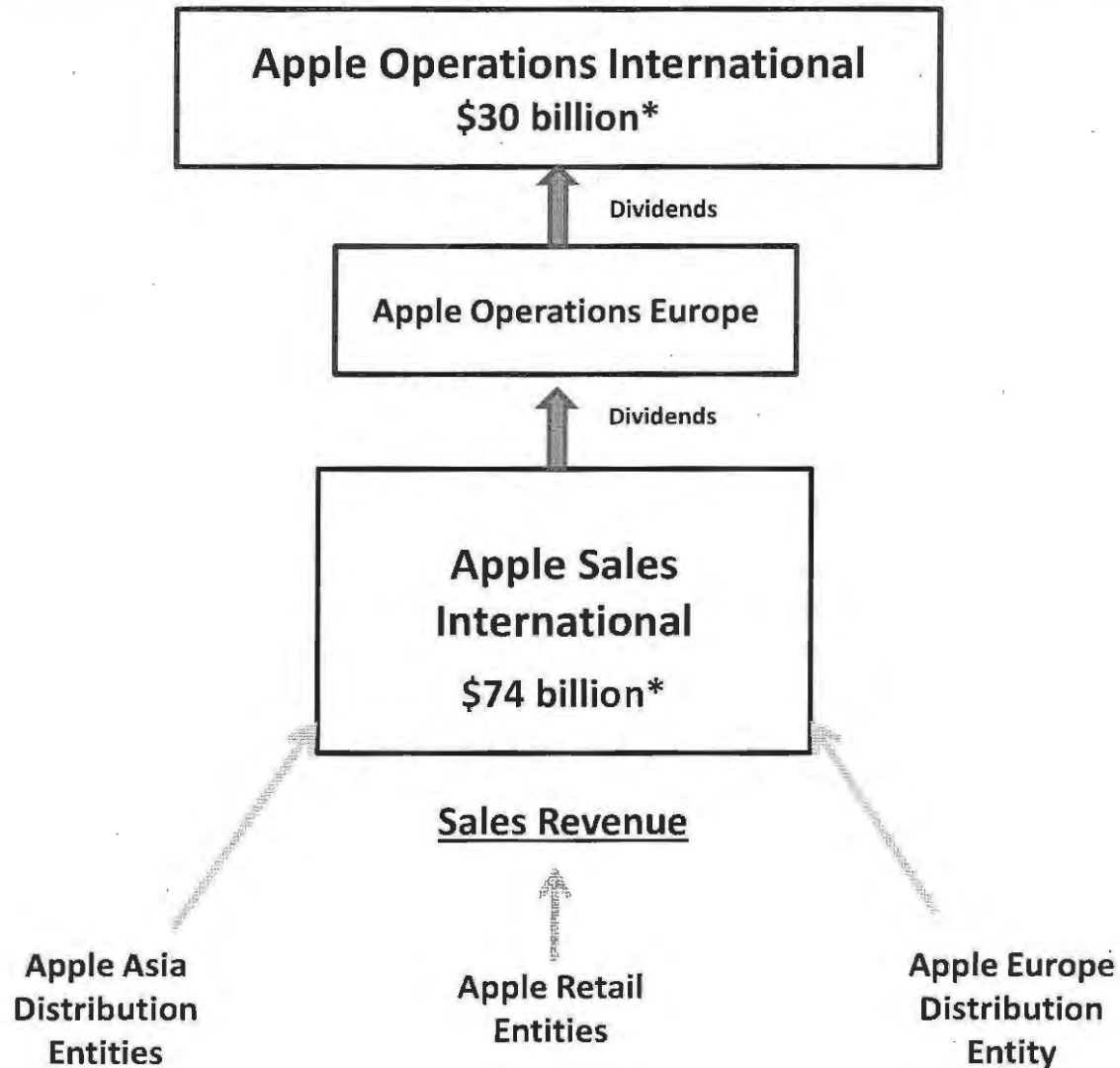
	Foreign Base Company Sales Income	Total Tax Avoided	Tax Avoided Per Day
2011	\$ 10 billion	\$ 3.5 billion	\$ 10 million
2012	\$ 25 billion	\$ 9.0 billion	\$ 25 million
<b>Total</b>	<b>\$ 35 billion</b>	<b>\$ 12.5 billion</b>	<b>\$ 17 million</b>

Source: Information provided to the Subcommittee by Apple, APL-PSI-000386.

Permanent Subcommittee on Investigations  
**EXHIBIT #1**

Prepared by the Permanent Subcommittee on Investigations, May 2013.

# Apple's Non-Tax Resident Entities

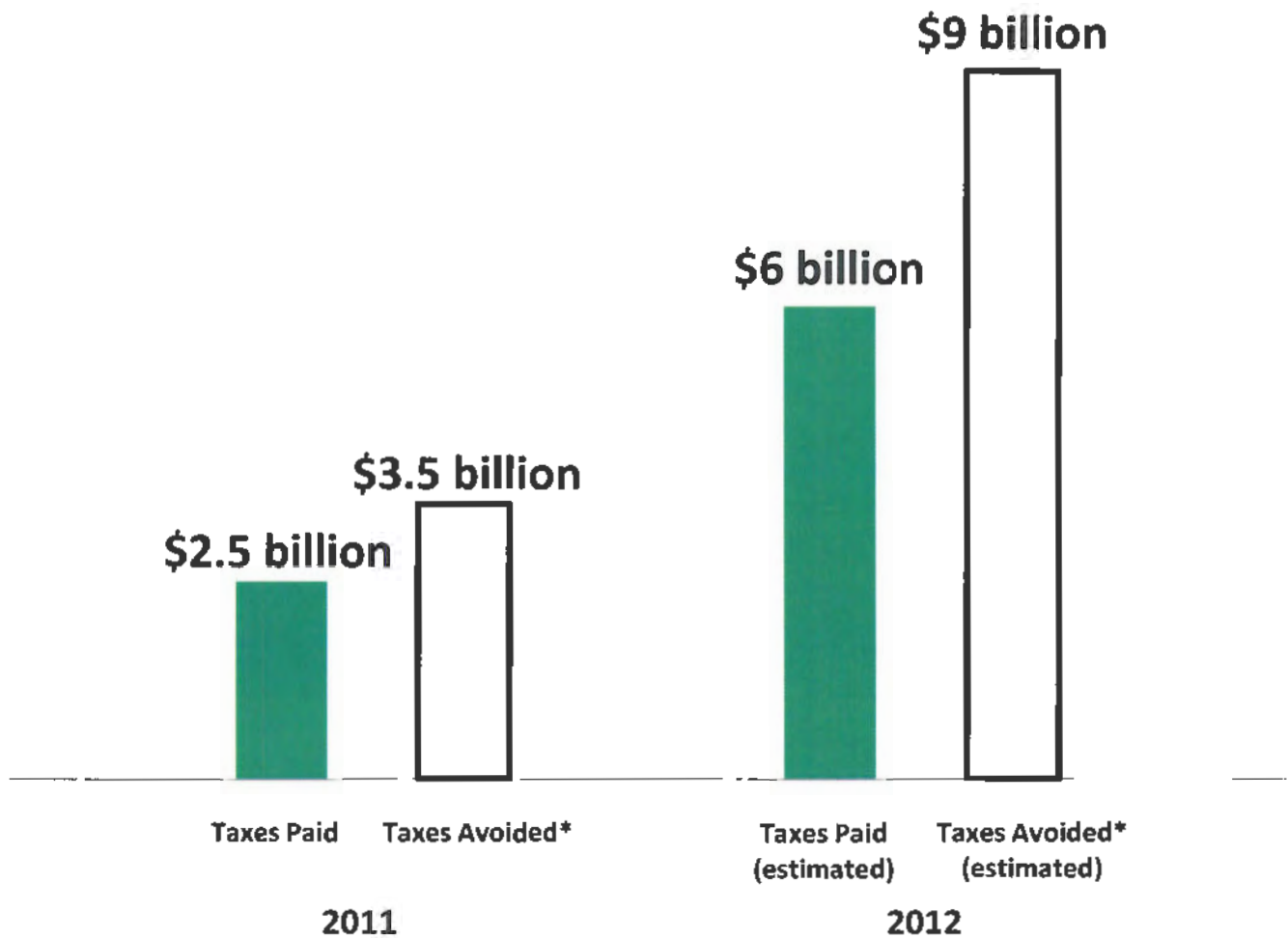


Permanent Subcommittee on Investigations  
**EXHIBIT #1k**

\* Income reported from 2009 to 2012

Prepared by the Permanent Subcommittee on Investigations, May 2013. Source: Materials received from Apple Inc.

## Apple: Avoiding Billions in U.S. Taxes



\* U.S. taxes were avoided using the Check the Box Loophole

Prepared by the Permanent Subcommittee on Investigations, May 2013. Source: Materials received from Apple Inc.

**AMENDED & RESTATED**  
**COST SHARING AGREEMENT**  
  
**Between**  
  
**APPLE INC.**  
  
**APPLE OPERATIONS EUROPE**  
  
**&**  
  
**APPLE SALES INTERNATIONAL**



APPLE INC.


By: 

Name: Peter Oppenheimer

Title: Senior Vice President & Chief  
Financial Officer

Date: May 22, 2008

APPLE SALES INTERNATIONAL

By: 

Name: Tim Cook

Title: Director

Date: May 23, 2008

APPLE OPERATIONS EUROPE

By: 

Name: Gary Wipfler

Title: Director

Date: May 22, 2008

**AMENDED AND RESTATED AGREEMENT TO SHARE COSTS AND RISKS**  
**OF INTANGIBLES DEVELOPMENT**  
**(GRANDFATHERED COST SHARING ARRANGEMENT)**

This AMENDED AND RESTATED AGREEMENT TO SHARE COSTS AND RISKS OF INTANGIBLES DEVELOPMENT ("Agreement") is entered into effective as of January 5, 2009 ("Effective Date") by and between:

**Apple Inc.**, a company organized and existing under the laws of California, U.S.A., with its principal place of business located at 1 Infinite Loop, Cupertino, California 95014, U.S.A. ("Apple"),

and

**Apple Operations Europe ("AOE")**, a company organized under the Irish Companies Act with a branch registered under the Singapore Companies Act, Cap. 50, to do business in Singapore and having a place of business at 7 Ang Mo Kio Street 64, Singapore 2056, and a branch doing business in Ireland at Hollyhill Industrial Estate, Hollyhill Cork, Ireland; and


**Apple Sales International ("ASI")**, a company organized under the Irish Companies Act doing business in Ireland at Hollyhill Industrial Estate, Hollyhill Cork, Ireland.

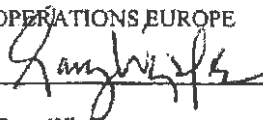
(Apple, AOE, and ASI are collectively referred to as the "Parties" and individually referred to as "Party")

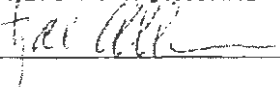
**RECITALS**

- A. Apple is the parent company of the Apple corporate group. Apple indirectly owns all of the shares of Apple Operations International ("AOI"), a company organized in Ireland. AOI in turn wholly owns AOE, which in turn wholly owns ASI.
- B. Each of AOE and ASI has, respectively, elected to be classified as a disregarded entity of AOI for U.S. federal income tax purposes under United States Treasury Regulation (hereinafter referred to as "Treas. Reg.") § 301.7701-3(a).
- C. Apple, AOE and ASI are engaged in the business of developing, manufacturing, or having manufactured, marketing and distributing the "Products" listed in Section 1.14.
- D. The Parties have previously entered into a qualified cost sharing arrangement in accordance with former Treas. Reg. § 1.482-7, effective as of September 30, 2007 (the "FY 2008 Cost Sharing Agreement"). The FY 2008 Cost Sharing Agreement amended and restated a qualified cost sharing arrangement in accordance with former Treas. Reg. § 1.482-7 that the Parties entered into, effective as of September 26, 1999, as amended effective as of September 28, 2003 (the "FY 2000 Cost Sharing Agreement (as amended)").

IN WITNESS WHEREOF, the Parties have caused this Agreement to be executed by their duly authorized representatives effective as of the Effective Date.

APPLE INC  
By:   
Name: Peter Oppenheimer  
Title: Senior Vice President & Chief Financial Officer  
Date: June 25, 2009

APPLE OPERATIONS EUROPE  
By:   
Name: Gary Wipfler  
Title: Director  
Date: June 25, 2009

APPLE SALES INTERNATIONAL  
By:   
Name: Jae Allen  
Title: Director  
Date: 25 JUNE 2009

September 15, 2004

Inspector of Taxes  
Large Cases Division  
Healthcare, ICT and Manufacturing  
Government Offices  
Sullivans Quay  
Cork

Attn: Tom Connor

**Re: Apple Computer Inc Ltd**

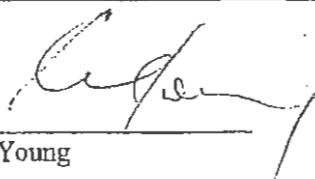
*Our ref: GM/A64/03*

Dear Sir,

We refer to your letter of September 13. The company is a non-resident holding company and is non-trading. In the circumstances there is nothing to return from the corporation tax standpoint.

If you require any further information, please let us know.

Yours truly,



Ernst & Young

joc

■ J. Bolland, N. Byrne, B. Cassidy, D. Clarke, J. Heffernan, P. Henehan, E. Kelly, K. Kenny, F. Kerr, M. O'Connor, E. O'Doherty, J. O'Leary, D. O'Neill, D. O'Sullivan, J. Ryan, P.G. Smith, D. Smyth, J. Somers.

The Irish firm Ernst & Young is a Member Practice of Ernst & Young Global. It is authorised by the Institute of Chartered Accountants in Ireland to carry on investment business in the Republic of Ireland.



Revenue 

www.revenue.ie

M/s Ernst & Young  
Stapleton House  
89 South Mall  
Cork

Office of the Revenue Commissioners  
Large Cases Division  
Healthcare, ICT and Manufacturing  
Government Offices  
Sullivans Quay  
Cork, Ireland

Oifig na gCoimisinéirí Ioncaim  
Rannán na gCásanna Móra  
Cúram Síálnte, TCE agus Déantúsaíocht  
Oifigí an Rialtais  
Port Uí Shúilleabháin  
Corcaigh, Éire

13 September 2004

Re: *Apple Computer Inc Ltd*


Your Ref: *GM/A 64/03*

Dear Sir/Madam

I note from my records the above company has not submitted any Corporation Tax returns. Could you let me know if the company is trading and if you intend to submit tax returns.

If you wish to contact me please telephone (021) 4325323.

Yours faithfully

  
Tom Connor  
For District Manager

Tel 021 4966077 Ext 72323 Fax 021 4325485 Direct Line 021 4325323

Apple Confidential - Need to Know

Appendix A: Apple Operations International - 2008-2012 Shareholder Meetings

FY 2008

Meeting Date	Meeting Location	Attendees* (Entity represented)	Country of Residence	Employer/Title
10-Jan-08	Cupertino, CA	Peter Oppenheimer (Apple Inc.) Gary Wipfler (Apple (UK) Limited) Peter Oppenheimer (Baldwin)	United States United States United States	Apple Inc., SVP, CFO Apple Inc., VP & Treasurer Apple Inc., SVP, CFO
16-Jul-08	Cupertino, CA	Peter Oppenheimer (Apple Inc.) Peter Oppenheimer (Apple (UK) Limited) Gene Levoff (Baldwin)	United States United States United States	Apple Inc., SVP, CFO Apple Inc., SVP, CFO Apple Inc., Director, Corporate Law

FY 2009

Meeting Date	Meeting Location	Attendees* (Entity represented)	Country of Residence	Employer/Title
3-Aug-09	Cupertino, CA	Peter Oppenheimer (Apple Inc.) Peter Oppenheimer (Apple (UK) Limited) Gene Levoff (Baldwin)	United States United States United States	Apple Inc., SVP, CFO Apple Inc., SVP, CFO Apple Inc., Director, Corporate Law

FY 2010

Meeting Date	Meeting Location	Attendees* (Entity represented)	Country of Residence	Employer/Title
23-Jul-10	Cupertino, CA	Peter Oppenheimer (Apple Inc.) Peter Oppenheimer (Apple (UK) Limited) Gene Levoff (Baldwin)	United States United States United States	Apple Inc., SVP, CFO Apple Inc., SVP, CFO Apple Inc., Director, Corporate Law

FY 2011

Meeting Date	Meeting Location	Attendees* (Entity represented)	Country of Residence	Employer/Title
27-Jun-11	Cupertino, CA	Audrey Fernandez-Elliott (Apple Inc.) Audrey Fernandez-Elliott (Apple (UK) Limited) Gene Levoff (Baldwin)	United States United States United States	Apple Inc., Senior Corporate Paralegal Apple Inc., Senior Corporate Paralegal Apple Inc., Director, Corporate Law

FY 2012

Meeting Date	Meeting Location	Attendees* (Entity represented)	Country of Residence	Employer/Title
17-Jul-12	Cupertino, CA	Gene Levoff (Apple Inc.) Tim Sheehan (Apple (UK) Limited)	United States United States	Apple Inc., Director, Corporate Law Apple Inc., Senior Corporate Paralegal

\* Meeting attendance was in person, unless otherwise noted.

Permanent Subcommittee on Investigations  
EXHIBIT #5

Questions from PSI May 14th Tax Call

1. **What percent of Apple's overall revenues are booked in each of its Irish entities and what is the total revenue for each entity?**

Of the \$108.25 billion of Net Sales reported on Apple Inc.'s Form 10-K for Period Ending September 24, 2011, approximately \$26.06 billion of worldwide Net Sales was recorded by Apple Sales International.

Apple Sales International was the only Irish entity with third party sales.

2. **What is the breakdown of employees for each Irish entity, by headcount, total compensation, percent of worldwide headcount, and percent of worldwide compensation?**

Apple's Irish headcount is provided in the table below. The table provides the Apple Irish headcount as a percentage of Apple's worldwide headcount. Additionally, we have provided Apple's Irish headcount as a percentage of Apple's worldwide headcount excluding Apple retail store employees as a meaningful comparison of functional headcount since Apple currently has no Apple retail stores in Ireland.

	Headcount (as of May 19, 2012)		
	<u>Headcount</u>	<u>% of WW Headcount</u>	
		<u>Total</u>	<u>Excluding Retail Store Employees</u>
Apple Distribution International	2,091	2.7%	6.7%
Apple Operations Europe	363	0.5%	1.2%
Apple Sales International	250	0.3%	0.8%
Apple Sales Ireland	5	0.0%	0.0%
Apple Operations	5	0.0%	0.0%
Apple Operations International <sup>†</sup>	0	0.0%	0.0%
Apple Retail Europe Holding <sup>†</sup>	0	0.0%	0.0%
<b>Total Irish Headcount</b>	<b>2,714</b>	<b>3.5%</b>	<b>8.7%</b>

<sup>†</sup> Note: Apple Operations International and Apple Retail Europe Holding are holding companies

<b>Total Compensation*</b> <b>(Est. Through FY2012)</b>		
	Amount (in millions)	% of WW Total
Total Irish Compensation	[REDACTED]	2.1%

\* Note: Apple does not forecast compensation at an entity level and therefore a breakdown of the total compensation by Irish entity is not readily available.

**3. Please identify the board members, corporate officers, and shareholders for each Irish entity, as well as Baldwin Holdings, including any corporations that may hold these positions.**

The following table identifies the Board Members and Corporate Officers of Apple's Irish entities as well as Baldwin Holdings Unlimited as of May 19, 2012:

Entity	Board Members	Corporate Officers
Apple Sales International	Cathy Kearney (Director) Gene Levoff (Director, Secretary) Elizabeth Rafael (Director) Mark Stevens (Director)	Gene Levoff (Secretary)
Apple Operations Europe	Cathy Kearney (Director) Gene Levoff (Director, Secretary) Gary Wipfler (Director)	Gene Levoff (Secretary)
Apple Distribution International	Cathy Kearney (Director) Gene Levoff (Director, Secretary) Michael O'Sullivan (Director)	Gene Levoff (Secretary)
Apple Sales Ireland	Cathy Kearney (Director) Gene Levoff (Secretary) Michael O'Sullivan (Director)	Gene Levoff (Secretary)
Apple Operations	Cathy Kearney (Director) Gene Levoff (Director, Secretary) Michael O'Sullivan (Director)	Gene Levoff (Secretary)
Apple Operations International	Cathy Kearney (Director) Gene Levoff (Director, Secretary) Gary Wipfler (Director)	Gene Levoff (Secretary)
Apple Retail Europe Holding	Cathy Kearney (Director) Jerome Maume (Secretary) Michael O'Sullivan (Director)	Jerome Maume (Secretary)
Baldwin Holdings Unlimited	Peter Oppenheimer (Director)	N/A



The following table identifies the shareholders for each of Apple's Irish entities as well as Baldwin Holdings Unlimited as of May 19, 2012:

Entity	Shareholders
Apple Sales International	Apple Operations Europe Apple Operations International Baldwin Holdings Unlimited
Apple Operations Europe	Apple Operations International Baldwin Holdings Unlimited
Apple Distribution International	Apple Operations International Apple Sales International Baldwin Holdings Unlimited
Apple Sales Ireland	Apple Operations Europe Apple Operations International Baldwin Holdings Unlimited
Apple Operations	Apple Operations International Baldwin Holdings Unlimited
Apple Operations International	Apple Inc. Apple (UK) Limited Baldwin Holdings Unlimited
Apple Retail Europe Holding	Apple Operations International Baldwin Holdings Unlimited
Baldwin Holdings Unlimited	Apple Inc.

#### 4. What factors contribute to Apple's 4% effective tax rate in Ireland?

Due to Ireland's overall attractive business environment, Apple has operated in Cork, Ireland since the 1980's and continues to use Ireland as its principal base of operations in Europe, including for some manufacturing and logistics; sales, accounting and finance; after sales support; and other functions. Apple has grown its operations in Ireland to include approximately 2,700 employees and recently announced Apple's intention to add 500 new jobs to the Cork facility and expand Apple's campus with an additional owned building.

Since the early 1990's, the Government of Ireland has calculated Apple's taxable income in such a way as to produce an effective rate in the low single digits, and this is the primary factor that contributes to Apple's rate. The rate has varied from year to year, but since 2003 has been 2% or less. This result is similar to incentives made available by many U.S. states and other countries to entice investment in their jurisdictions.

5. Since 2003, what is the total amount of dividends paid to Apple Operations International by other entities, by year?

<u>Fiscal Year</u>	<u>Amount of Dividends</u>
2004	\$ 8,444,194
2005	\$ 0
2006	\$ 1,269,328,781
2007	\$ 57,033,000
2008	\$ 0
2009	\$ 101,477,000
2010	\$ 8,082,328,428
2011	\$ 6,381,029,926
Total	\$ 15,899,641,329

6. Since 2003, what is Apple's total amount of interest earnings subject to Subpart F taxation, by year?

The Subpart F income reported on Apple's federal income tax return included the following amounts:

<u>Fiscal Year</u>	<u>Interest Earnings</u>	<u>Other Earnings<sup>#</sup></u>	<u>Total</u>
2004			
2005			
2006			
2007			
2008			
2009			
2010			
2011			
Total	\$1,532,279,622	\$ 58,979,835	\$1,591,259,457

<sup>#</sup> Note: The Other Earnings reported on Apple's federal income tax return as Subpart F Income consisted of other Foreign Personal Holding Company Income derived from Apple's foreign currency management, bank fees and other miscellaneous income and expense.

7. Since 2003, please list any other earnings subject to Subpart F taxation, by year.

See the response to question 6 above.

— = Redacted by the Permanent Subcommittee on Investigations

US Senate Permanent Subcommittee on Investigations

June 1, 2012 Questionnaire

1. Please provide your corporate legal name and address and the name, address, telephone number and e-mail address of the individual who will serve as our primary contact and who can answer questions about your questionnaire responses.

**Apple Legal Name/Address:** Apple Inc.  
1 Infinite Loop  
Cupertino, CA 95014

**Apple Primary Contact:** Catherine A. Novelli  
Vice President, Worldwide Government Affairs  
901 15<sup>th</sup> Street, NW Suite 1000  
Washington, DC 20005  
Phone: (202) 772-9505  
Email: cnovelli@apple.com

2. Please provide an organizational chart depicting your company's worldwide legal and operational structure, including related offshore entities. In addition, please identify all of your company's offshore headquarters.

Please find attached in Appendix A, an organizational chart which depicts Apple's worldwide legal ownership structure, and a high level operational structure chart for the distribution of finished goods. Apple does not have offshore headquarters companies, but its principal offshore trading activities take place in Ireland through Apple Distribution International and in Singapore through Apple South Asia Pte. Ltd.

For responses to the questions below, to the extent that the request calls for financial information, please provide information for each of your fiscal years 2009, 2010, and 2011. Please submit information only for the years for which the requested information has not already been provided to the Subcommittee.

For purposes of Apple's responses hereafter, references to fiscal years 2009, 2010, and 2011 shall mean years ending September 26, 2009, September 25, 2010, and September 24, 2011, respectively.

3. What percentage amount of your company's world-wide revenues were:  
a. booked or recorded in the U.S.?

<u>FY2009</u>	<u>FY2010</u>	<u>FY2011</u>
52%	44%	39%

- b. booked or recorded outside the U.S.?

<u>FY2009</u>	<u>FY2010</u>	<u>FY2011</u>
48%	56%	61%

- c. from sales to customers located in the U.S.?

<u>FY2009</u>	<u>FY2010</u>	<u>FY2011</u>
52%	44%	39%

Appendix C  
Apple Non-US Subsidiaries  
as of Sept 24, 2011 (FY11)

Subsidiary's Name	CFC	If CFC, Controlling entity	Incorporation Date	Incorporating Jurisdiction	Subsidiary's Headquarters	Location for Tax Purposes
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**Redacted by the  
Permanent Subcommittee on Investigations**

Apple Distribution International	No		5/11/09	Ireland	Hollyhill Industrial Estate, Hollyhill, Cork, Ireland	Ireland
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**Redacted by the  
Permanent Subcommittee on Investigations**

Appendix C  
 Apple Non-US Subsidiaries  
 as of Sept 24, 2011 (FY11)

Subsidiary's Name	CFC	If CFC, Controlling entity	Incorporation Date	Incorporating Jurisdiction	Subsidiary's Headquarters	Location for Tax Purposes
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**Redacted by the  
 Permanent Subcommittee on Investigations**

Apple Operations	No		12/8/10	Ireland	Hollyhill Industrial Estate, Hollyhill, Cork, Ireland	Ireland
Apple Operations Europe	No		8/5/80	Ireland	Hollyhill Industrial Estate, Hollyhill, Cork, Ireland	Ireland

**Appendix C**  
**Apple Non-US Subsidiaries**  
as of Sept 24, 2011 (FY11)

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Subsidiary's Name	CFC	IFCFC, Controlling entity	Incorporation Date	Incorporating Jurisdiction	Subsidiary's Headquarters	Location for Tax Purposes
Apple Operations International	Yes	Apple Inc. (U.S.)	8/6/80	Ireland	Hollyhill Industrial Estate, Hollyhill, Cork, Ireland	---

**Redacted by the  
Permanent Subcommittee on Investigations**

**Appendix C**  
**Apple Non-US Subsidiaries**  
as of Sept 24, 2011 (FY11)

Subsidiary's Name	CFC	If CFC, Controlling entity	Incorporation Date	Incorporating Jurisdiction	Subsidiary's Headquarters	Location for Tax Purposes
Apple Sales International	No		4/4/90	Ireland	Hollyhill Industrial Estate, Hollyhill, Cork, Ireland	Ireland
Apple Sales Ireland	No		12/17/81	Ireland	Hollyhill Industrial Estate, Hollyhill, Cork, Ireland	Ireland

**Redacted by the  
Permanent Subcommittee on Investigations**

Baldwin Holdings Unlimited	Yes	Apple Inc. (U.S.)	3/21/06	Virgin Islands, British	Tricor Services (BVI) Limited, PO Box 3340, Road Town, Tortola, Virgin Islands, British	Virgin Islands, British
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# Apple Non-US Subsidiaries

As of FY2009, 2010 and 2011

Appendix D

Subsidiary's Name	Number of Employees			(In \$ millions) Compensation		
	FY2009	FY2010	FY2011	FY2009	FY2010	FY2011
Apple (UK) Limited	263	285	309			
	87	105	160			
	115	113	410			
	78	94	117			
	1,036	1,575	2,283			
	0	0	0			
	0	0	0			
	29	37	38			
	465	200	294			
	0	0	0			
	0	4	8			
Apple Distribution International	0	0	0			
	91	229	491			
	296	352	384			
	155	167	180			
	14	18	20			
	206	233	252			
	0	0	0			
	0	4	10			
	39	71	92			
	69	94	105			
	2	2	2			
	792	869	1,060			
	32	34	46			
	7	9	6			
	74	91	110			
	28	38	46			
	n/a	2	11			
	34	15	8			
	n/a	n/a	0			
Apple Operations Europe	1,572	2,326	2,452			

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**Redacted by the  
Permanent Subcommittee on Investigations**

**Redacted by the  
Permanent Subcommittee on Investigations**



# Apple Non-US Subsidiaries

As of FY2009, 2010 and 2011

Appendix D

Subsidiary's Name	Number of Employees			(in \$ millions) Compensation		
	FY2009	FY2010	FY2011	FY2009	FY2010	FY2011
Apple Operations International	0	0	0	0	0	0

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Apple Sales International	0	0	0	0	0	0
Apple Sales Ireland	7	6	6	1	1	2

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Permanent Subcommittee on Investigations

Baldwin Holdings Unlimited	0	0	0	0	0	0
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Produced Pursuant to Senate Rules XXVI(5)(b)(5)

APL-PSI-000104

# Apple Non-US Subsidiaries

As of FY2009, 2010 and 2011

Appendix D

Subsidiary's Name	Number of Employees			(in \$ millions) Compensation		
	FY2009	FY2010	FY2011	FY2009	FY2010	FY2011
<div style="border: 2px solid black; padding: 10px; width: fit-content; margin: 0 auto;"> <p><b>Redacted by the Permanent Subcommittee on Investigations</b></p> </div>						
Total	8,729	13,526	19,650			

**Appendix E**  
**Apple Non-US Subsidiaries**  
as of Sept 24, 2011 (FY11)

Subsidiary's Name	US Tax Classification	Foreign Tax Classification	"Check-the-Box" or "Look-Through Rule" relied upon to reduce FPHCI
Apple (UK) Limited	Corporation	Corporation	N/A
Apple Asia Limited	Disregarded Entity	Corporation	N/A

**Redacted by the  
Permanent Subcommittee on Investigations**

Apple Computer Trading (Shanghai) Co. Ltd.	Disregarded Entity	Corporation	N/A
Apple Computer UK Partners	Disregarded Entity	Corporation	N/A

**Redacted by the  
Permanent Subcommittee on Investigations**

Apple Holding B.V.	Disregarded Entity	Corporation	N/A
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Apple Japan G.K.	Disregarded Entity	Corporation	N/A
Apple Japan, Inc.	Corporation	Corporation	N/A

**Redacted by the  
Permanent Subcommittee on Investigations**

**Appendix E**  
**Apple Non-US Subsidiaries**  
as of Sept 24, 2011 (FY11)

— = Redacted by the Permanent  
Subcommittee on Investigations

Subsidiary's Name	US Tax Classification	Foreign Tax Classification	"Check-the-Box" or "Look-Through Rule" relied upon to reduce FPHCI
[Redacted]			
Apple Netherlands BV	Disregarded Entity	Corporation	N/A
Apple Operations	Disregarded Entity	Corporation	N/A
Apple Operations Europe	Disregarded Entity	Corporation	Yes
Apple Operations International	Corporation	Corporation	Yes
[Redacted]			
Apple Pty Limited	Disregarded Entity	Corporation	Yes
Apple Retail Belgium BVBA	Disregarded Entity	Corporation	N/A
Apple Retail Europe Holding	Disregarded Entity	Corporation	N/A
Apple Retail France E.U.R.L.	Disregarded Entity	Corporation	N/A
Apple Retail Germany GmbH	Disregarded Entity	Corporation	N/A
Apple Retail Italia S.R.L.	Disregarded Entity	Corporation	N/A
Apple Retail Netherlands B.V.	Disregarded Entity	Corporation	N/A
Apple Retail Spain, S.L.	Disregarded Entity	Corporation	N/A
Apple Retail Switzerland GmbH	Disregarded Entity	Corporation	N/A
Apple Retail UK Limited	Disregarded Entity	Corporation	N/A
[Redacted]			
Apple Sales International	Disregarded Entity	Corporation	N/A
Apple Sales Ireland	Disregarded Entity	Corporation	N/A
Apple Sales New Zealand	Disregarded Entity	Corporation	N/A
[Redacted]			

Appendix E  
Apple Non-US Subsidiaries  
as of Sept 24, 2011 (FY11)

Redacted by the Permanent  
Subcommittee on Investigations

Subsidiary's Name	US Tax Classification	Foreign Tax Classification	"Check-the-Box" or "Look-Through Rule" relied upon to reduce FPHCI
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Apple South Asia Pte. Ltd.	Disregarded Entity	Corporation	N/A
[REDACTED]	[REDACTED]	[REDACTED]	[REDACTED]
Baldwin Holdings Unlimited	Corporation	Corporation	N/A

[REDACTED]

**Appendix J**  
**Cash Reserves and Amounts Paid to Top 5 non-U.S. Subsidiaries**  
*(in millions of US\$)*

Top 5 non-U.S. Subsidiaries	Reasons funds paid to the Top 5 non-U.S. Subsidiaries	Amount excluded due to check-the-box/look-through #
<b>FY2009</b>		
Apple Sales International	Intercompany sales, services and loans	\$ 1,281
Apple Operations Europe	Intercompany sales and services	\$ 135
Apple Operations International	Intercompany dividends	\$ 78
Apple Asia Limited	Intercompany services	\$ 10
Apple South Asia Pte Ltd	Intercompany sales and services	\$ 41
<b>FY2010</b>		
Apple Sales International	Intercompany sales, services and loans	\$ 5,552
Apple Operations International	Intercompany dividends	\$ 8,082
Apple Asia Limited	Intercompany services	\$ 8
Apple South Asia Pte Ltd.	Intercompany sales and services	\$ 134
FileMaker International	Intercompany sales	\$ -
<b>FY2011</b>		
Apple Sales International	Intercompany sales, services and loans	\$ 11,092
Apple Operations International	Intercompany dividends	\$ 6,381
Apple Distribution International	Intercompany sales	\$ 2,356
Apple Asia Limited	Intercompany services	\$ 10
Apple South Asia Pte Ltd.	Intercompany sales and services	\$ 240

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- \* The amounts received represent approximate balances as the payments and receipts of funds may have been netted for administrative convenience.
- # The amount identified as excluded due to check-the-box or look-through represents the gross sales margin or other intercompany amounts received. Such amounts have not been adjusted for certain allocable expenses. As such, these amounts do not represent the subpart F income that might have been associated with the identified intercompany transactions.

**U.S. Senate Permanent Subcommittee on Investigations**

**Follow Up Question Dated September 03, 2012**

1. For the fiscal years 2009, 2010, and 2011, please provide a breakdown of any research and development expenses attributed to any entity participating in such activity.

Apple Inc., Apple Sales International ("ASI"), and Apple Operations Europe ("AOE") participate in a long-standing R&D cost sharing arrangement pursuant to which each participant bears expenses based on their respective geographic territories. Pursuant to your request for additional information, we provide the following supplemental information:

*(in millions of US\$)*

	<b>FY2009</b>	<b>FY2010</b>	<b>FY2011</b>
Apple Inc./Filemaker (US)	737	867	1,031
ASI/AOE (Ireland)	596	915	1,397
Total Worldwide R&D Expense*	1,333	1,782	2,428

Notes:

\* R&D expense under U.S. Generally Accepted Accounting Principles ("GAAP").

Apple

	Legal Name	FY09	FY10	FY11
US	Apple Inc. (Includes Apple Value Services, LLC)	1,248,754	1,696,046	2,302,784
US		5,738	5,575	8,312
US		0	-86	-118
US		17,489	17,825	18,627
		2,517	2,331	2,707
	Apple Operations Europe	18,832	12,064	17,164
	Apple Sales International	0	0	13,707

Subcommittee Note:  
 This table provides a break out of aggregate numbers listed on page APL-PSI-000129

Total GAAP R&D	<u>1,332,662</u>	<u>1,781,892</u>	<u>2,428,274</u>
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 Produced Pursuant to Senate Rule XXVI(5)(b)(5)

APL-PSI-000233



## Apple Operations International - 2009-2011 Minutes

2009

Meeting Date	Description	Meeting Location	Attendees	Title	Employer
21-Sep-09	Minutes of a Meeting of the Board of Directors	Cupertino, CA	Peter Oppenheimer Gary Wipfler	SVP, CFO VP & Treasurer	Apple Inc.

2010

Meeting Date	Description	Meeting Location	Attendees	Title	Employer
23-Jul-10	Minutes of a Meeting of the Board of Directors	Cupertino, CA	Peter Oppenheimer Gary Wipfler	SVP, CFO VP & Treasurer	Apple Inc.
15-Sep-10	Minutes of a Meeting of the Board of Directors	Cupertino, CA	Peter Oppenheimer Gary Wipfler	SVP, CFO VP & Treasurer	Apple Inc.
23-Sep-10	Minutes of a Meeting of the Board of Directors	Cupertino, CA	Peter Oppenheimer Gary Wipfler	SVP, CFO VP & Treasurer	Apple Inc.
26-Oct-10	Minutes of a Meeting of the Board of Directors	Cupertino, CA	Peter Oppenheimer Gary Wipfler	SVP, CFO VP & Treasurer	Apple Inc.

2011

Meeting Date	Description	Meeting Location	Attendees	Title	Employer
7-Sep-11	Minutes of a Meeting of the Board of Directors	Cupertino, CA	Gene Levoff Gary Wipfler	Director, Corporate Law VP & Treasurer	Apple Inc.

Permanent Subcommittee on Investigations  
**EXHIBIT #9**

Excerpt from September 12, 2012 information supplied by Apple to the Permanent Subcommittee on Investigations.

**Excerpt from January 11 & 18, 2013 information  
supplied by Apple to the Permanent  
Subcommittee on Investigations.**

<b>Entity</b>	<b>Shareholders</b>	<b>Percentage Ownership</b>
Apple Sales International	Apple Operations Europe Apple Operations International Baldwin Holdings Unlimited	> 99.99% <.001% <.001%
Apple Operations Europe	Apple Operations International Baldwin Holdings Unlimited	>99.99% <.001%
Apple Distribution International	Apple Operations International Apple Sales International Baldwin Holdings Unlimited	90.253% 9.657% 0.09%
Apple Sales Ireland	Apple Operations Europe Apple Operations International Baldwin Holdings Unlimited	>99.99% <.001% <.001%
Apple Operations	Apple Operations International Baldwin Holdings Unlimited	99.9% 0.1%
Apple Operations International	Apple Inc. Apple (UK) Limited Baldwin Holdings Unlimited	96.418% 3.581% .001%
Apple Retail Europe Holding	Apple Operations International Baldwin Holdings Unlimited	>99.99% <.001%

**Redacted by the  
Permanent Subcommittee on Investigations**

8. Please confirm whether Irish corporation rules require second nominee shareholders such as Baldwin to be located in a foreign jurisdiction.

Certain Irish Corporation principles require companies to have a second shareholder that is located outside of the European Union.

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- d. **If not, what were the factors and reasons cited as being the basis for that determination?**
- e. **Did Apple make a request or make any initial inquiries about granting AOI such a status before Ireland made its decision?**
- f. **If so, please describe the circumstances surrounding Apple's actions regarding this matter.**
- g. **Please identify the reasons why Apple believes that AOI should not be designated as a tax resident and why that determination was reached?**

Apple Operations International is an Irish incorporated holding company whose primary purpose is to hold shares of Apple international subsidiaries. Since its inception, Apple determined that AOI was not a tax resident of Ireland. Apple made this determination based on the application of the central management and control tests under Irish law. Although we are not aware whether the Irish government has made a specific determination regarding the tax residency of AOI, it has not challenged Apple's determination.

12. **Has any jurisdiction determined or declared that AOI is tax resident in its or any other jurisdiction?**

Not to the best of our knowledge. However, AOI had a taxable presence in France from Tax Years 1987 to 2007. See response to Question 14.

- a. **If so please identify the jurisdictions which have made such a determination, where Apple has been determined to be tax resident and the reason for the determination(s).**

N/A

13. **If Apple has not declared AOI to be tax resident in any jurisdiction, please explain why.**

As described above, it was determined that AOI is not a tax resident of Ireland notwithstanding that Ireland is its country of incorporation. The determination of tax residency is to be conducted on a country by country basis, applying the residency tests and requirements as determined under applicable local laws. Apple does not believe that AOI qualifies as a tax resident of any other country under the applicable local laws.

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14. Has AOI ever filed a corporate income tax return with the national government of any jurisdiction? If so, please identify the jurisdiction, the year the return was filed, and the amount of income reported on the return.

AOI filed corporate income tax returns in France for Tax Years 1987-2007. During those years, AOI owned a building in France from which it earned rental income. AOI sold the building in Tax Year 2007. Taxable income for Tax Years 1994-2007 is provided below. Data relating to Tax Years 1987-1993 is not readily available.

Year Return Filed	Taxable Income (FF to TY01) (EUR from TY02)
FY94	2,444,298
FY95	2,490,621
FY96	18,005,739
FY97	1,809,054
FY98	350,806
FY99	258,984
FY00	1,107,191
FY01	760,778
FY02	105,360
FY03	128,753
FY04	200,891
FY05	115,339
FY06	187,185
FY07	5,402,440

15. For its past three fiscal years please identify by year the amount of income tax AOI has paid to any national government, the amount paid to each government and the government to which it was paid.

For the past three fiscal years, AOI has not filed any corporate income taxes with any national government. However, please note that interest income generated by AOI has been included in Apple Inc.'s US tax return as subpart F income.

**US Senate Permanent Subcommittee on Investigations  
Follow Up Questions Dated February 11 2013**

- 1. Please describe the central management and control tests under Irish law. What criteria were applied by Apple and what were the facts and reasoning applied that led to its determination that AOI was not managed and controlled in Ireland?**

Under Irish law, factors that would demonstrate management and control in Ireland include:

1. All directors' meetings should be physically held in Ireland.
2. The majority of directors should live in Ireland.
3. All major decisions should be made at directors'/shareholders' meetings. Directors must be able to make decisions of substance as to investment, marketing, purchasing, etc. The Articles of Association of the Company should provide that all directors' meetings are held in Ireland.
4. The quorum for directors meetings should be such that a majority of Irish resident directors is required to conduct a valid board meeting.
5. Major contracts should be negotiated in Ireland.
6. All important policy questions should be decided in Ireland.
7. All shareholders' meetings, if possible, including EGM's, should take place in Ireland.
8. The company's main accounting records should be kept in Ireland.
9. The accounts should, in the main, be written up in Ireland.
10. Minute books of company meetings should be kept in Ireland.
11. The company seal (if any) should be kept in Ireland.
12. The share register should be kept in Ireland.
13. Dividends should be declared in Ireland.
14. The company should have bank accounts in Ireland.

To the best of our knowledge, AOI does not meet any of the Irish central management and control factors stated above.

- 2. According to data provided to the Subcommittee, AOI has three shareholders: Apple Inc. which owns 96.4 percent; Apple (UK) Limited which owns 3.6 percent; and Baldwin Holdings Unlimited which owns .001%. Has**

**Apple determined that the location of any of these entities is the location of central management and control of AOI? If so, which entity and why? If not, why not?**

No. Location of shareholders is not relevant to the application of the central management and control test under Irish law.

3. **According to data provided to the Subcommittee, the board of directors of AOI consists of Cathy Kearney of Ireland, Gene Levoff of the United States, and Gary Wipfler of the United States. Has Apple determined that the location of any of these directors is the location of central management and control of AOI? If so, which jurisdiction and why? If not, why not?**

No. As noted in response to question 1, the location of the majority of directors is one of the fourteen factors that are applied in determining whether AOI's central management and control is in Ireland (Factor 2). That factor is not satisfied because only one of AOI's three directors is located in Ireland.

4. **For Irish tax law purposes, is it Apple's determination that AOI is not managed and controlled in any jurisdiction?**
- a. **If so, please identify the criteria applied by Apple and the facts and reasoning that led Apple to reach that conclusion and, if so, how management is management and control exercised?**
  - b. **If not, please identify where Apple determined the location of AOI's central management and control to be situated and identify the criteria applied by Apple and the facts and reasoning that led Apple to reach that conclusion.**

Apple has not made a determination regarding the location of AOI's central management and control. Rather, Apple has determined that AOI is not managed and controlled in Ireland based on the application of the central management and control test under Irish law. The conclusion that AOI is not managed and controlled in Ireland does not require a determination where AOI is managed and controlled.

5. **Functionally (i.e. for organizational and daily operational purposes), where does Apple Inc. consider AOI to be managed and controlled?**

a. **What facts and reasoning led Apple to that conclusion?**

Apple has not determined the location of AOI's central management and control for organizational and daily operational purposes. Apple has concluded that AOI is not managed and controlled in Ireland based on the application of the central management and control test under Irish law, as discussed in the response to Question 1.

6. **In its January 18, 2013 response to the Subcommittee, Apple wrote that following about the tax residence of AOI:**

*Since its initial formation, Apple Operations International has not had a tax residence in Ireland and is not believed to be a tax resident of any other jurisdiction, although it had a taxable presence in France from 1987 until 2007.*

a. **Please identify the criteria applied by Apple and the facts and reasoning applied that led Apple to conclude that AOI is not tax resident in Ireland.**

Apple Operations International ("AOI") is an Irish incorporated holding company whose primary purpose is to hold shares of certain other Apple subsidiaries incorporated outside the United States.

Under Section 23A, of Ireland's Taxes Consolidation Act 1997 ("TCA") a company that is incorporated in Ireland will be regarded as a tax resident in Ireland. However, a company will not be so regarded if it is a relevant company and it either carries on a trade in Ireland or it is related to a company which carries on a trade in Ireland. A relevant company is a company:

1. which is under the control, directly or indirectly, of a person or persons who is or are-
  - (I) by virtue of the law of any relevant territory, resident for the purposes of tax in a relevant territory or territories, and
  - (II) not under the control, directly or indirectly, of a person who is, or persons who are, not so resident, or
2. which is, or is related to, a company the principal class of shares of which is substantially and regularly traded on one or more recognized stock exchanges in a relevant territory or territories.

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A relevant territory is another Member State in the European Union or a territory with which Ireland has a tax treaty. AOI is considered a relevant company and therefore is not deemed to be Irish tax resident as a result of being incorporated in Ireland. A company which is not tax resident in Ireland under the "place of incorporation" test above will be tax resident in Ireland if its central management and control is located there. As described in response to question one, AOI's central management and control is not located in Ireland.

- b. **In its January 18, 2013 response to the Subcommittee, Apple wrote the following about its determination that AOI is not a tax resident of any country:**

*As described above, it was determined that AOI is not a tax resident of Ireland notwithstanding that Ireland is its country of incorporation. The determination of tax residency is to be conducted on a country by country basis, applying the residency tests and requirements as determined under applicable local laws. Apple does not believe that AOI qualifies as a tax resident of any other country under the applicable local laws.*

**Please identify the criteria applied by Apple and the facts and reasoning applied that led Apple to conclude that AOI is not tax resident in the jurisdiction that is the location of AOI's central management and control.**

Apple has not made a determination regarding the location of AOI's central management and control. Rather, Apple has applied the central management and control test under Irish law and determined that AOI is not a tax resident of Ireland notwithstanding the fact that AOI is incorporated in Ireland. Apple has not concluded that AOI is not tax resident in the jurisdiction that is the location of AOI's central management and control.

- c. **Under Irish law, if the jurisdiction where Apple determined AOI to be managed and controlled and an income tax structure that resulted in AOI having to pay income tax, would Apple consider AOI to be tax resident in that jurisdiction?**

The determination of tax residency depends on the corporate residency rules of



individual jurisdictions. Irish law is not controlling for determining tax residency anywhere other than Ireland.

- d. **If the jurisdiction where Apple determined AOI to be managed and controlled did not have an income tax, would Apple consider AOI to be tax resident of that jurisdiction?**

Tax residency is a jurisdiction-specific inquiry. If the corporate tax residency laws of a jurisdiction led Apple to conclude that AOI was a tax resident of that jurisdiction, Apple would apply that jurisdiction's tax laws with respect to AOI, without regard to whether that jurisdiction had an income tax.

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Permanent Subcommittee on Investigations**

7. **According to data provided to the Subcommittee, AOI reported interest income of \$100.4 million, \$46.7 million, and \$3.5 million in FY 2011, 2010, and 2009 respectively.**
  - a. **Of this interest income, how much was included as Subpart F income on Apple's US tax return? How much in taxes was paid on the reported amount?**

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AOI's reported interest income for FY2009, 2010, and 2011 was included in full in the calculation of subpart F income in Apple Inc.'s US tax returns for each of the relevant years, subject to application of the provisions of IRC Sections 951-954. The subpart F inclusion for AOI as finally determined for each year was included in Apple Inc.'s US federal income tax return for the relevant year and subject to US taxation.

- b. If a portion of this interest income was excluded, or if the tax liability was reduced or eliminated, please provide the amount and reason for any exclusion, reduction or elimination.**

N/A

- c. Please explain any tax provision that was primarily relied upon to reduce taxes paid in the U.S. (e.g. check-the-box or the earnings and profits limitation).**

See response to 7a, above.

- d. According to data provided to the Subcommittee, it appears that interest income and intercompany dividends are AOI's primary source of income. Did AOI have any other sources of income in FY 2009, FY 2010, and FY 2011? If so, what were the sources and amount of income?**

AOI did not have any material source of income other than interest income and intercompany dividends.

- 8. According to Apple's September 12, 2012 response to the Subcommittee, AOI paid taxes of \$14,546 in FY 2011 and had a deferred tax liability of \$117,077 in FY 2009.**

- a. To what local or national governments did AOI pay taxes or are taxes owed? Please identify the government, the amount paid to each, and a description of the reason for such payments.**

In FY2011, Apple France paid a dividend to its shareholders, including AOI, which owns 0.25% of Apple France. The dividend was subject to a 25% French withholding tax. The gross dividend to AOI was Euro 41,250, with withholding tax

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deducted of EUR 10,312.50 (approximately US \$14,546). The withholding tax was paid to the French government.

- b. According to Apple's August 15, 2012 response to the Subcommittee, AOI had an effective tax rate of 6.9%, 0.2%, and 0.7% and a deferred tax rate of 11.2%, 17.8%, and 17.3% in FY 2009, 2010, and 2011 respectively. What portion of this tax is attributable to AOI and what portion is attributable to Apple Inc.? To which governments were these taxes paid or deferred, and in what portions?

		2009	2010	2011
Current - French	AOI	--	--	0.1%
Deferred - French	AOI	0.1%	--	--
Current - US	Apple Inc.	6.9%	0.2%	0.6%
Deferred - US	<u>Apple Inc.</u>	<u>11.1%</u>	<u>17.8%</u>	<u>17.3%</u>
Total		<u>18.1%</u>	<u>18%</u>	<u>18%</u>

- c. Please explain the reason for the deferred tax liability.

The foreign deferred tax expense recognized in FY 2009 relates to the accounting for the tax effects of the disposition of French real estate in FY 2007.

**Redacted by the  
Permanent Subcommittee on Investigations**

**Redacted by the  
Permanent Subcommittee on Investigations**

- c. **What percentage of AOI's earnings were characterized as indefinitely reinvested in each of FY 2009, FY 2010, and FY 2011?**

Approximately 50% of the non-subpart F earnings of AOI (representing intercompany dividends received from international subsidiaries) were characterized as indefinitely reinvested during this time period.

10. **According to Apple's August 15, 2012 response to the Subcommittee, dividends account for 100% of AOI's intercompany funds.**

- a. **What individuals at Apple are involved in the determination or recommendation of whether dividends should be paid to AOI? For each individual, please list the country of residence, job title, and the Apple entity for which he/she is employed. Please provide a copy of any written analysis or recommendation.**

Apple's corporate treasury and corporate legal departments make recommendations regarding intercompany dividend distributions to be made by subsidiaries of AOI. Gary Wipfler is Vice President and Corporate Treasurer of Apple Inc and Gene Levoff is Director of Corporate Law of Apple Inc. The other key decision makers with respect to dividend distributions are the Directors of the AOI subsidiaries that paid the dividends. Please see App. 2 for a list of these individuals.

**Redacted by the  
Permanent Subcommittee on Investigations**

MINUTES OF A MEETING OF THE BOARD OF DIRECTORS OF  
APPLE OPERATIONS EUROPE  
(the "Company")

DULY CONVENED, CONSTITUTED AND HELD AT  
One Infinite Loop, Cupertino, California, 95014 USA  
on 17 November 2010

PRESENT: Peter Oppenheimer, Director  
Gary Wipfler, Director  
APOLOGIES: Cathy Kearney, Director

1. CHAIRMAN

It was agreed that Gary Wipfler would chair the meeting.

2. QUORUM

The Chairman noted that a quorum of two directors was present and that the meeting had been properly convened and constituted. The directors had no personal interests in the matter to be discussed. The interests of Peter Oppenheimer as a director of Apple Operations International and of Baldwin Holdings Unlimited had already been noted in the records of the Company.

3. RECEIPT OF INTERIM ORDINARY DIVIDEND

IT WAS NOTED that the Company was to receive on 18th November 2010 a dividend in the amount of US\$1,750,000,000 from Apple Sales International. A review of the Company's financial statements to 26th September 2009 also indicated substantial retained profits of [REDACTED] available for distribution. Interim Dividends had been received subsequent to the 26<sup>th</sup> September 2009 in the total amount of US\$6,574,972,906.56 and interim dividends had been paid in the total amount of US\$7,909,796,428 which left [REDACTED]

4. PAYMENT OF INTERIM ORDINARY DIVIDEND

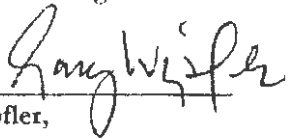
IT WAS RESOLVED that subject to the receipt of an interim dividend in the amount of US\$1,750,000,000 from Apple Sales International, an interim dividend in respect of the year ending 25<sup>th</sup> September 2010, as justified by the profits of the Company and by the dividend to be received, be paid in the total amount of US\$1,750,000,000 on the 18<sup>th</sup> of November 2010, to Apple Operations International as shareholder of the Company (Baldwin Holdings Unlimited having mandated payment of its dividend to Apple Operations International).

[REDACTED] = Redacted by the Permanent  
Subcommittee on Investigations

Permanent Subcommittee on Investigations  
EXHIBIT #12

5. CLOSE

There being no further business the Chairman declared the meeting closed.

  
\_\_\_\_\_  
Gary Wipfler,  
Chairman

— Redacted by the Permanent Subcommittee on Investigations

Excerpt from April 26, 2013 information supplied by Apple to the Permanent Subcommittee on Investigations.

Apple Operations International - Board of Directors Meetings During Tim Cook Directorship*				
Meeting Date	Meeting Location	Attendees**	Apologies	Summary
8-May-06	N/A	N/A	N/A	Tim Cook appointed a director of the company effective this date.
15-May-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler	None listed	[REDACTED]
18-May-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	Resolving to seek shareholder resolution to renew Director's authority to elect shares to Baldwin Holdings Unlimited.
18-May-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Cathy Kearney	None listed	[REDACTED]
18-May-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Cathy Kearney	None listed	[REDACTED]
19-May-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	[REDACTED]
19-May-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Cathy Kearney	None listed	Resolving to allot 1 ordinary share of AOI and Apple Computer Limited, Apple Computer Europe Holding Limited and Apple Computer (Sales) to Baldwin Holdings Unlimited.
22-May-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	Resolving to re-register as an unlimited company.
25-May-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	Resolving to change company's name to "Apple Operations International."
30-May-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	[REDACTED]
8-Jun-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	Payment of dividends to Apple Computer, Inc., in the amount of \$1,157,019,903 and to Apple Computer UK Limited in the amount of \$42,980,097 on June 30, 2006.
13-Jun-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	[REDACTED]
12-Jul-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook, Cathy Kearney (by phone)	N/A	Resolving to approve a Letter of Intent relating to the lease back of premises in France.
28-Jul-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	Resolving to empower certain individuals to manage AOI's banking, investment, brokerage, and other accounts.
28-Jul-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook, Cathy Kearney (by phone)	N/A	Resolving to approve the sale of premises in France owned by AOI.
12-Sep-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	Payment of dividends to Apple Computer, Inc., in the amount of \$905,717,725 and to Apple Computer UK Limited in the amount of \$11,282,275 on September 21, 2006.
12-Sep-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	[REDACTED]
11-Oct-06	Cupertino, CA	Peter Oppenheimer, Tim Cook, Gary Wipfler	None listed	[REDACTED]
19-Oct-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	[REDACTED]
15-Nov-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler	None listed	[REDACTED]
5-Jan-07	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	[REDACTED]
13-Apr-07	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	[REDACTED]
22-May-07	Cupertino, CA	Peter Oppenheimer, Gary Wipfler	None listed	[REDACTED]
27-Jun-07	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	Resolving to approve the draft Directors Report and financial statements for FY 2007; setting date of Annual General Meeting; noting that interim dividends of \$1,515,000,000 were paid during the year; appointing Peter Oppenheimer as representative for AOE and ASI AGMs.
10-Jan-08	Cupertino, CA	Peter Oppenheimer, Gary Wipfler	None listed	Noting AGM previously convened for July 20, 2007 was not held; resolving to date of Annual General Meeting (AGM) for Jan. 10, 2008; noting that interim dividends of \$1,515,000,000 were paid during the year; appointing Gary Wipfler as representative for AOE and ASI AGMs.
10-Jan-08	Cupertino, CA	Peter Oppenheimer, Gary Wipfler	None listed	[REDACTED]
21-Sep-09	Cupertino, CA	Peter Oppenheimer, Gary Wipfler	Tim Cook, Cathy Kearney	[REDACTED]
28-Oct-09	N/A	Peter Oppenheimer, Gary Wipfler, Cathy Kearney	N/A	Written resolution and Request of the Directors resolving that Tim Cook shall vacate his office as a director of AOI effective this date.

Permanent Subcommittee on Investigations  
EXHIBIT #13

Apple Operations Europe - Board of Directors Meetings During Tim Cook Directorship*				
Meeting Date	Meeting Location	Attendees**	Apologies	Summary
				* This list reflects Board minutes for years during which Tim Cook was a director of AOE, as well as documents reflecting his appointment and removal as a director. Some minutes list both present directors and those sending apologies. Others list only those present.
				** Attendance in person unless otherwise noted
8-May-06	Cupertino, CA	Gary Wipfler, Peter Oppenheimer, Cathy Kearney	None listed	Resolving to appoint Tim Cook as an additional director of the company effective this date.
15-May-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler	None listed	
18-May-06	Cupertino, CA	Gary Wipfler, Peter Oppenheimer, Tim Cook	None listed	Resolving to distribute a written resolution allotting one ordinary share in the company to Baldwin Holdings Unlimited.
18-May-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Cathy Kearney	None listed	
19-May-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	
19-May-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Cathy Kearney	None listed	Resolving to allot one ordinary share to Baldwin Holdings Unlimited.
22-May-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	Resolving to re-register as an unlimited company.
25-May-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	Resolving to distribute a written resolution to change the name of "Apple Computer Limited" to "Apple Operations Europe" to avoid confusion with its parent companies.
12-Jun-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	
13-Jun-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	
24-Jul-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	Resolving to retain Braeburn Capital Inc. to assist AOE in managing its cash reserves.
28-Jul-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	Resolving to allow the opening, maintenance, closure of banking, investment, brokerage, and other accounts in the name of AOE.
12-Sep-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	
11-Oct-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	
5-Jan-07	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	
26-Jun-07	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	Resolving to approve the draft Directors' Report and financial statements for FY 2006, noting that interim dividends of \$1,249,875,000 were paid during the year.
10-Jan-08	Cupertino, CA	Peter Oppenheimer, Gary Wipfler	None listed	
10-Jan-08	Cupertino, CA	Peter Oppenheimer, Gary Wipfler	None listed	Resolving to consent to short notice for the Annual General Meeting for January 10, 2008, noting that interim dividends of \$1,249,875,000 were paid during the year.
10-Jan-08	Cupertino, CA	Peter Oppenheimer, Gary Wipfler	None listed	
17-Dec-08	Cupertino, CA	Gary Wipfler, Peter Oppenheimer, Gene Levoff (listed as "in attendance")	None listed	
14-Jan-09	Cupertino, CA	Peter Oppenheimer, Gary Wipfler	None listed	
22-Jul-09	Cupertino, CA	Peter Oppenheimer (by phone), Gary Wipfler (by phone)	Tim Cook, Cathy Kearney	Resolving to execute a Business Transfer Agreement to transfer the business of the AOE Singapore Branch to Apple South Asia Pte. Ltd.
23-Oct-09	Cupertino, CA	Peter Oppenheimer, Gary Wipfler	Tim Cook, Cathy Kearney	Noting the upcoming receipt of a dividend of \$3,482,850,781.21 from ASI on October 27, 2009, and resolving to pay AOE a dividend of \$4,607,274,566.29 on October 27, 2009.
21-Dec-09	N/A	Peter Oppenheimer, Gary Wipfler, Cathy Kearney	N/A	



Apple Sales International - Board of Directors Meetings During Tim Cook Directorship\*

This list reflects Board minutes for years during which Tim Cook was a director of ASI, as well as documents reflecting his appointment and removal as a director. Some minutes list both present directors and those sending apologies. Others list only those present. \*\* Attendance in person unless otherwise noted

Meeting Date	Meeting Location	Attendees**	Apologies	Summary
8-May-06	Cupertino, CA	Gary Wipfler, Peter Oppenheimer, Joe Allen	None listed	
15-May-06	Cupertino, CA	Gary Wipfler, Peter Oppenheimer, Joe Allen	None listed	
18-May-06	Cupertino, CA	Gary Wipfler, Peter Oppenheimer, Joe Allen	None listed	Resolving to distribute written resolutions to the shareholder recommending that EUR3,142,764.20 of ASI's reserve be capitalized and appropriated as capital, the 900,000 shares of EUR1,269778 each in the capital of ASI certified as fully paid and allotted.
18-May-06	Cupertino, CA	Gary Wipfler, Peter Oppenheimer, Joe Allen	None listed	Resolving to allot EUR3,142,764.20 of ASI's reserves to be capitalized and appropriated as capital, the 900,000 shares of EUR1,269778 each in the capital of ASI certified as fully paid and allotted to Apple Computer, Limited.
19-May-06	Cupertino, CA	Tim Cook, Gary Wipfler, Peter Oppenheimer	None listed	
24-Jul-06	Cupertino, CA	Tim Cook, Gary Wipfler, Peter Oppenheimer, Joe Allen	None listed	Resolving to rein in GreenTree Capital Inc. to assist ASI in maintaining its cash resources.
28-Jul-06	Cupertino, CA	Gary Wipfler, Peter Oppenheimer, Joe Allen	None listed	
12-Sep-06	Cupertino, CA	Tim Cook, Gary Wipfler, Peter Oppenheimer	None listed	
11-Oct-06	Cupertino, CA	Peter Oppenheimer, Gary Wipfler, Tim Cook	None listed	
3-Jan-07	Cupertino, CA	Tim Cook, Gary Wipfler, Peter Oppenheimer	None listed	
9-May-07	Cupertino, CA	Tim Cook, Peter Oppenheimer	None listed	
26-Jun-07	Cupertino, CA	Tim Cook, Peter Oppenheimer	None listed	
26-Jun-07	Cupertino, CA	Tim Cook, Gary Wipfler, Peter Oppenheimer	None listed	Resolving to approve the draft Directors Report and financial statements for the year ending September 30, 2006; noting that \$1,254,000,000 of Interim dividends were paid during the year.
23-Jul-07	Cupertino, CA	Tim Cook, Gary Wipfler, Peter Oppenheimer	None listed	
10-Jan-08	Cupertino, CA	Peter Oppenheimer, Gary Wipfler	None listed	Noting that interim dividends in the amount of \$1,250,000,000 were paid during the financial year.
23-Oct-08	Cupertino, CA	Peter Oppenheimer, Joe Allen	Cathy Kearney, Tim Cook	Resolving to pay ADE an interim dividend of \$3,482,850,783.23 on October 27, 2008.
10-Feb-09	N/A	Peter Oppenheimer, Joe Allen, Cathy Kearney (signature)	N/A	
1-Mar-10	N/A	Peter Oppenheimer, Cathy Kearney, Joe Allen, Elizabeth Rafael (signature)	N/A	
12-May-10	Cupertino, CA	Elizabeth Rafael, Joe Allen	Peter Oppenheimer, Cathy Kearney, Tim Cook	Resolving to pay an Interim Dividend of \$3,000,000,000 to ADE on May 30, 2010.
16-Jun-10	Cupertino, CA	Peter Oppenheimer, Elizabeth Rafael	Joe Allen, Tim Cook, Cathy Kearney	Resolving to pay an interim dividend of \$800,000,000 to ADE on June 17, 2010.
22-Jun-10	Cupertino, CA	Peter Oppenheimer, Elizabeth Rafael	Joe Allen, Tim Cook, Cathy Kearney	
23-Jul-10	Cupertino, CA	Peter Oppenheimer, Elizabeth Rafael	Joe Allen, Tim Cook, Cathy Kearney	
20-Sep-10	Cupertino, CA	Peter Oppenheimer, Joe Allen	Elizabeth Rafael, Cathy Kearney, Tim Cook	Resolving to pay an interim dividend of \$400,000,000 to ADE on September 21, 2010.
17-Nov-10	Cupertino, CA	Peter Oppenheimer, Elizabeth Rafael	Joe Allen, Tim Cook, Cathy Kearney	Resolving to pay ADE an interim distribution of \$1,750,000,000 on Nov. 18, 2010.
21-Dec-10	Cupertino, CA	Peter Oppenheimer, Elizabeth Rafael	Joe Allen, Tim Cook, Cathy Kearney	
4-Mar-11	Cupertino, CA	Betsy Rafael, Peter Oppenheimer	None listed	Resolving to pay an interim dividend of \$1,000,000,000 to ADE on March 7, 2011 noting the resignation of Joe Allen as a director and the appointment of Mark Stevens as a director effective March 15, 2011.
21-Mar-11	Cupertino, CA	Peter Oppenheimer, Betsy Rafael	None listed	Resolving to pay an interim dividend of \$1,000,000,000 to ADE on March 24, 2011.
21-Apr-11	Cupertino, CA	Elizabeth Rafael, Mark Stevens	None listed	
11-May-11	Cupertino, CA	Peter Oppenheimer, Elizabeth Rafael	Tim Cook, Cathy Kearney, Mark Stevens	Resolving to pay ADE an interim distribution of \$1,000,000,000 on May 12, 2011.
28-Jun-11	Cupertino, CA	Mark Stevens, Elizabeth Rafael	Peter Oppenheimer, Cathy Kearney, Tim Cook	Noting the resignation of Peter Oppenheimer as director and secretary and the appointment of Gene Lovell as director and secretary in his stead; resolving that the Directors Report and financial statements for the period ending September 30, 2010 be approved; noting that interim dividends of \$1,300,000,000 were declared and paid to ADE.
27-Jul-11	Cupertino, CA	Gene Lovell, Elizabeth Rafael	Tim Cook, Cathy Kearney, Mark Stevens	
7-Sep-11	Cupertino, CA	Gene Lovell, Elizabeth Rafael	Cathy Kearney, Mark Stevens	Resolving to pay an interim dividend of \$1,500,298,132 to ADE on September 8, 2011.
27-Sep-11	Cupertino, CA	Gene Lovell, Elizabeth Rafael	Tim Cook, Cathy Kearney, Mark Stevens	Noting that interim dividends totaling \$4,750,000,000 in cash and \$1,500,000,000 in specie had been paid since September 28, 2010; resolving to pay an interim dividend of \$2.5 billion to ADE.
10-Nov-11	Cupertino, CA	Gene Lovell, Elizabeth Rafael	Tim Cook, Cathy Kearney, Mark Stevens	
13-Jan-12	Cupertino, CA	Gene Lovell, Elizabeth Rafael	Tim Cook, Cathy Kearney, Mark Stevens, Peter Oppenheimer	Resolving to pay an interim dividend of \$2.5 billion to ADE immediately.
7-Mar-12	Cupertino, CA	Gene Lovell, Elizabeth Rafael	Tim Cook, Cathy Kearney, Mark Stevens	Resolving to pay an interim dividend of \$4,000,000,000 to ADE immediately.
1-May-12	N/A	Tim Cook (signature)	N/A	Letter from Tim Cook resigning as a director of ASI effective this date.

Appendix C  
PSI Question 8

### Apple Operations International - FY08 and FY 12 Board of Directors Meeting Information

#### FY 2008

Meeting Date	Meeting Location	Attendees*	Employer/Title
10-Jan-08	Cupertino, CA	Peter Oppenheimer Gary Wipfler	Apple Inc., SVP, CFO Apple Inc., VP & Treasurer

#### FY 2012

Meeting Date	Meeting Location	Attendees	Employer/Title
17-Jul-12	Cupertino, CA	Gene Levoff Gary Wipfler	Apple Inc., Director, Corporate Law Apple Inc., VP & Treasurer
7-Aug-12	Cork, Ireland	Gene Levoff (by telephone) Cathy Kearney	Apple Inc., Director, Corporate Law Apple Distribution International, VP European Operations

\* Attendance in person unless otherwise noted

Permanent Subcommittee on Investigations  
**EXHIBIT #14**

Excerpt from May 3, 2013 information supplied  
by Apple to the Permanent Subcommittee on  
Investigations.

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Permanent Subcommittee on Investigations

6. **Please describe the relationship between AOE and ASI with respect to their ownership of the economic rights to the intellectual property that they have obtained from Apple Inc.**

AOE and ASI are participants in a Cost Sharing Arrangement with Apple Inc. whereby AOE, ASI and Apple Inc. have agreed to pool their resources for purposes of undertaking intellectual property co-development activities that are incorporated into Apple products and to share the benefits and rewards of such development in their respective territories. Apple Inc. has the rights, among others, to manufacture or have manufactured, sell and distribute Apple products in North America, South America, Central America and the Caribbean (the "Americas") and AOE and ASI have the rights, among others, to manufacture or have manufactured, sell and distribute Apple products in the worldwide territory excluding the Americas.

7. **Please state Apple's business purpose for the formation of (1) AOI and (2) Baldwin Holdings. In addition, what functions are performed by each and where are those functions performed?**

We have not located historical records about the business purpose for the formation of AOI in 1980. However, as previously noted, AOI is a holding company whose primary purpose is to hold shares of Apple international subsidiaries and to centralize treasury management of international cash.

The business purpose of Baldwin Holdings is to act as nominee shareholder of AOI and other Irish entities. Certain Irish Corporation principles require companies to have a second shareholder that is located outside of the European Union. As a separate subsidiary, it also provides limited liability protection to Apple. As a nominee shareholder, Baldwin Holdings does not have any operational function.

8. **What is the purpose, business or otherwise, for locating AOI in Ireland?**

We have not located historical records that document the original purpose for locating AOI in Ireland in 1980, but it was incorporated there at the same time that Apple commenced its longstanding business presence in Ireland. AOI

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continues to serve its primary purpose as holding company and to centralize treasury management of international cash. Apple is not aware of a business reason today to change AOI's location today and to do so would be needlessly complex, time-consuming, and expensive.

- 10. For US tax purposes, is Baldwin Holdings considered an owner of the companies for which it is a shareholder? If not, who are the owners and what is Baldwin's status considered to be? Please provide any documents maintained by Apple to support these answers.**

Baldwin Holdings Unlimited holds bare legal title to the single share it holds in the relevant entities and acts as a nominee for the shareholder that has the benefits and burdens of the shares to which Baldwin Holdings Unlimited holds bare legal title. For US tax purposes, Baldwin Holdings Unlimited's nominal ownership interest in these entities is disregarded.

<u>Entity</u>	<u>Owner for US tax purposes</u>
Apple Operations International	Apple Inc.
Apple Operations Europe	Apple Operations International
Apple Distribution International	Apple Operations International
Apple Sales International	Apple Operations International
Apple Sales Ireland	Apple Operations International
Apple Operations	Apple Operations International
Apple Retail Europe Holding	Apple Operations International

See Appendix C for copies of relevant Nominee Agreements with Baldwin Holdings Unlimited.

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Permanent Subcommittee on Investigations**

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Permanent Subcommittee on Investigations**

18. Did Apple Inc. use foreign earnings to finance its recent dividend payments to shareholders, whether through repatriation, short-term loan, or some other method? If so, please describe the method employed and the amount involved. Does Apple plan to do so for future dividend payments or stock buy-backs?

Apple Inc. did not use foreign earnings to finance its recent dividend payments to shareholders, whether through repatriation, short-term loan or another method. Apple does not have any current plan to use foreign earnings for future dividend payments or stock buy-backs.

We said in April that we would fund our return of capital program through calendar year 2015 from current domestic cash, future cash generated in the US, and domestic borrowings.

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Permanent Subcommittee on Investigations**

US Senate Permanent Subcommittee on Investigations  
Follow Up Questions Dated April 15, 2013

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Permanent Subcommittee on Investigations

**11. Why did Apple make the determination to transfer the economic rights to its intellectual property to a foreign jurisdiction?**

We have not located historical information regarding why Apple made the determination to enter into a cost sharing agreement in 1980. However, we note that the formation of the cost sharing arrangement was contemporaneous with Apple's decision to establish a European base of operations in Ireland, including a manufacturing facility. Through the cost sharing arrangement, ASI/AOE (or their predecessors) partially funded and shared the risks and benefits of the co-developed intellectual property and obtained the right to manufacture and distribute product in their territory.

**12. In addition to the information already provided by Apple, please provide the amounts of any other buy-in or cost sharing payments made to Apple Inc. in conjunction with the execution or amendment of Apple's cost sharing agreements with its foreign subsidiaries or affiliates. Please identify any entity that made any payments and the dates of the payments.**

We have not located historical information regarding any buy-in payments associated with the original cost sharing agreement dating back to 1980. To the best of our knowledge, there were no other buy-in or cost sharing payments made to Apple Inc. specifically in conjunction with the execution or amendment of Apple's cost sharing agreements with its foreign subsidiaries or affiliates.

However, ASI and AOE made payments for cost sharing or buy-ins that were not in conjunction with the execution or amendment of Apple's cost sharing agreements.

Appendix H to the July 6 PSI submission, APL-PSI-000113, reflects these payments from FY2009-FY2011. One additional payment in the amount of \$472 million for FY2011 was inadvertently omitted from Appendix H, though Apple separately disclosed it to the Subcommittee on June 22, 2012, in the Company's Response to Question 10.

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During FY2012, Apple Inc. charged ASI/AOE the following amounts relating to cost sharing, buy-ins or platform contribution transactions (PCT), or transfer of intangible property:

- cost sharing of \$1,657,558,523
- platform contribution transactions of \$215,843,121
- other Treas. Reg. § 1.482-4 transfer of intangible property: \$371,504,618

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Permanent Subcommittee on Investigations**

- 15. For the years 2006 to present, please provide the annual gross income, total sales, operating income and pre-tax income for each of the entities that, for the purposes of Apple's cost sharing agreement, was determined to receive economic benefit from Apple's intellectual property, both in the Americas and the rest of the world. Please indicate whether each entity is considered part of the Americas or the rest of the world.**

AOE and ASI are parties to the cost sharing agreement with Apple Inc. Apple Inc's territory is defined in the cost sharing agreement as North America, South America, Central America and the Caribbean (the "Americas") while AOE and ASI's territory is defined as the worldwide territory excluding the Americas. See Appendix C for the annual gross income (margin), total sales, operating income, and pre-tax income for fiscal years 2006 to 2012 for ASI, AOE and Apple Inc. These are the only entities that, for purposes of Apple's cost sharing agreement, receive economic benefit from Apple's intellectual property.

- 16. Given that ASI, an Irish entity, regularly purchases personal property from a third party manufacturer outside of Ireland, and sells the personal property to related parties for use, consumption, or disposition outside of Ireland, please describe whether IRC 954(d) (related to Foreign Base Company Sales Income) applied or currently applies to income received by ASI, or any of Apple's other Irish entities, during the period 2008 to present and if so, the amount of income it applied or applies to. Please indicate whether any analysis was conducted on this issue. If so, please indicate who performed the analysis, the conclusion reached and the amount of any income determined to be subject to 954(d). In addition, please provide the analysis.**

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IRC section 954(d) generally does not apply to income received by ASI or any of Apple's other Irish entities during the period 2008 to present because sales made to third parties are generally made through disregarded entities.



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**Apple's ten largest entities by exclusion amount.**

Apple does not routinely perform this calculation since IRC Section 954(d) does not apply to these transactions due to check the box or look through rules. However, as requested, we have estimated the hypothetical foreign base company sales and foreign personal holding company income as follows for FY2009-2012. (This analysis assumes that the "same country" dividend exception under IRC Section 954(c)(3) and the substantial contribution test of the contract manufacturing exception would not otherwise apply.)

	(Amounts in millions of dollars)			
	<u>FY2009</u>	<u>FY2010</u>	<u>FY2011</u>	<u>FY2012</u>
Apple Sales International	1,191	4,698	9,823	24,614
Apple Distribution International	-	21	155	350
Apple South Asia Pte Ltd	4	7	16	180
Hypothetical FBCSI income	<u>1,195</u>	<u>4,726</u>	<u>9,994</u>	<u>25,144</u>
Apple Operations Europe				
Dividends	-	6,575	6,253	14,900
Less: PTI	-	(5,889)	(6,253)	(14,900)
	<u>-</u>	<u>686</u>	<u>-</u>	<u>-</u>
Apple Operations International				
Dividends	101	8,082	6,381	15,457
Less: PTI	-	(6,575)	(6,253)	(14,900)
	<u>101</u>	<u>1,507</u>	<u>128</u>	<u>557</u>
Hypothetical FPHCI income	<u>101</u>	<u>2,193</u>	<u>128</u>	<u>557</u>
Total hypothetical subpart F	<u>1,296</u>	<u>6,919</u>	<u>10,122</u>	<u>25,701</u>

**Redacted by the  
Permanent Subcommittee on Investigations**

**US Senate Permanent Subcommittee on Investigations  
Follow Up Questions Dated April 15, 2013**

- 4. Which individuals at Apple are responsible for negotiating or signing master servicing agreements with third-party manufacturers on behalf of Apple Inc, AOE, and ASI? Please identify the title, position, employer, and country of residence of each individual.**

As discussed during our May 14, 2013 telephone call with PSI staff, we are answering this question and Question 5 concerning individuals responsible for negotiating or signing agreements with Foxconn and the makers of the A5 chip.

Foxconn is a trade name for Hon Hai Precision Industry Co., Ltd. ("Hon Hai"). The individuals with primary responsibility for negotiating agreements with Hon Hai for products containing the A5 chip were U.S.-based Apple Inc. employees working in Operations. Their titles and positions include Vice President, Operations; Vice President, Procurement; Senior Director, Procurement; Director, Procurement; and Business Operations Manager. In exceptional cases, Apple's Senior Vice President, Operations, was involved. An Apple Shanghai employee with the title of Manager, APO Business Operations was also involved in negotiations. Individuals signing the relevant agreements for Apple Inc. were U.S.-based Apple Inc. employees with the title VP, Procurement. The individual who signed the relevant agreements for Apple Sales International was a U.S.-based Apple Inc. employee who signed the agreement in his capacity as Director of Apple Sales International.

The individuals with primary responsibility for negotiating relevant agreements with Samsung, the manufacturer of the A5 chip, were Apple Inc. employees working in the U.S. with the title of Senior Director, Operations, and Director, Procurement. The individuals who signed the relevant agreements for Apple Inc. were U.S.-based Apple Inc. employees with titles/positions of: Sr. Director, Operations, and Director, GSM. The individual who signed the relevant agreements for Apple Sales International was a U.S.-based employee of Apple Inc. who signed the agreements in his capacity as Director of Apple Sales International.

AOE is not a party to the agreements with Hon Hai or Samsung referred to herein.

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Permanent Subcommittee on Investigations**

**Email Question from D. Goshorn dated May 16, 2013: Could you please confirm for us whether Apple considered ASI to not be a tax resident of Ireland at any point from 2009 to present?**

From 2009 to present, ASI has not met the tax residency requirements in Ireland. However, ASI is an operating company that files an Irish corporate tax return and pays Irish corporate income tax as required by Ireland. As we indicated in our response to Question 8(c) of our July 6, 2012 submission, ASI's location for tax purposes is Ireland because ASI files a corporate tax return in Ireland.

## Apple Inc. 10-K Select Figures 2009-2012

Year	Effective Tax Rate	Income before provision for income tax	"Provision for income" tax each year	"Provision for income" tax each year	"Provision for income" tax each year	"Provision for income" tax each year	"Provision for income" tax each year	Total "Net Sales"	Gross profit ("gross margin")	Operating profit ("operating income")	Total cash	Cash offshore ("held by foreign subsidiaries")
			Total	Federal Current	Federal Deferred	Foreign Current	Foreign Deferred					
2012*	25.20%	\$55,763 bil	\$14,030 bil	\$7,240 bil	\$5,018 bil	\$1,203 bil	\$(490) mil	\$156,508 bil	\$68,662 bil	\$55,241 bil	\$121,251 bil	\$82.6 bil
2011**	24.20%	\$34,205 bil	\$8,283 bil	\$3,884 bil	\$2,998 bil	\$769 mil	\$(167) mil	\$108,249 bil	\$43,818 bil	\$33,790 bil	\$81,570 bil	\$54.3 bil
2010***	24.40%	\$18,540 bil	\$4,527 bil	\$2,150 bil	\$1,676 bil	\$282 mil	\$(121) mil	\$65,225 bil	\$25,684 bil	\$18,385 bil	\$51,011 bil	\$30.8 bil
2009****	31.80%	\$12,066 bil	\$3,831 bil	\$1,922 bil	\$1,077 bil	\$345 mil	\$(35) mil	\$42,905 bil	\$17,222 bil	\$11,740 bil	\$33,992 bil	\$17.4 bil

### KEY

Page number of the applicable Form 10-K in ( )

\*Form 10-K (for fiscal year ended 9/29/2012), <http://files.shareholder.com/downloads/AAPL/2452435818x0xS1193125-12-444068/320193/filing.pdf>.

\*\*Form 10-K (for fiscal year ended 9/24/2011), <http://files.shareholder.com/downloads/AAPL/2452435818x0xS1193125-11-282113/320193/filing.pdf>.

\*\*\*Form 10-K (for fiscal year ended 9/25/2010), <http://files.shareholder.com/downloads/AAPL/2452435818x0xS1193125-10-238044/320193/filing.pdf>.

\*\*\*\*Form 10-K/A (amended 1/25/2010, for fiscal year ended 9/26/2009), <http://files.shareholder.com/downloads/AAPL/2452435818x0xS1193125-10-12091/320193/filing.pdf>.

# APPLE INC

## FORM 10-K/A (Amended Annual Report)

Filed 01/25/10 for the Period Ending 09/26/09

Address	ONE INFINITE LOOP CUPERTINO, CA 95014
Telephone	(408) 996-1010
CIK	0000320193
Symbol	AAPL
SIC Code	3571 - Electronic Computers
Industry	Computer Hardware
Sector	Technology
Fiscal Year	09/30

## Table of Contents

### PART II

#### Item 6. Selected Financial Data

The Consolidated Balance Sheets as of September 26, 2009 and September 27, 2008, and the Consolidated Statements of Operations for the years ended September 26, 2009, September 27, 2008, and September 29, 2007 have been amended to reflect the impact of the retrospective adoption of the new accounting principles, which has been reflected in the following table. There was no impact from the retrospective adoption of the new accounting principles for the years ended September 30, 2006 and September 24, 2005. Those years predated the Company's introduction of iPhone and Apple TV.

The information set forth below for the five years ended September 26, 2009, is not necessarily indicative of results of future operations, and should be read in conjunction with Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and related notes thereto included in Part II, Item 8 of this Form 10-K to fully understand factors that may affect the comparability of the information presented below (in millions, except share amounts which are reflected in thousands and per share amounts).

	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Net sales	\$ 42,905	\$ 37,491	\$ 24,578	\$ 19,315	\$ 13,931
Net income	\$ 8,235	\$ 6,119	\$ 3,495	\$ 1,989	\$ 1,328
Earnings per common share:					
Basic	\$ 9.22	\$ 6.94	\$ 4.04	\$ 2.36	\$ 1.64
Diluted	\$ 9.08	\$ 6.78	\$ 3.93	\$ 2.27	\$ 1.55
Cash dividends declared per common share	\$ —	\$ —	\$ —	\$ —	\$ —
Shares used in computing earnings per share:					
Basic	893,016	881,592	864,595	844,058	808,439
Diluted	907,005	902,139	889,292	877,526	856,878
Cash, cash equivalents and marketable securities	\$ 33,992	\$ 24,490	\$ 15,386	\$ 10,110	\$ 8,261
Total assets	\$ 47,501	\$ 36,171	\$ 24,878	\$ 17,205	\$ 11,516
Long-term debt	\$ —	\$ —	\$ —	\$ —	\$ —
Total liabilities	\$ 15,861	\$ 13,874	\$ 10,347	\$ 7,221	\$ 4,088
Shareholders' equity	\$ 31,640	\$ 22,297	\$ 14,531	\$ 9,984	\$ 7,428

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The Company's Other Segments experienced an increase in net sales of \$1.0 billion, or 59% during 2008 as compared to 2007. These increases are related primarily to strong growth in sales of iPhone, Mac portable systems, iPods and iMac in the Company's Asia Pacific region. Sales from the iTunes Store in the Company's Asia Pacific region grew 109% compared to 2007.

## Gross Margin

Gross margin for the three years ended September 26, 2009, are as follows (in millions, except gross margin percentages):

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Net sales	\$42,905	\$37,491	\$24,578
Cost of sales	<u>25,683</u>	<u>24,294</u>	<u>16,426</u>
Gross margin	<u>\$17,222</u>	<u>\$13,197</u>	<u>\$ 8,152</u>
Gross margin percentage	40.1%	35.2%	33.2%

The gross margin percentage in 2009 was 40.1% compared to 35.2% in 2008. The primary contributors of the increase in 2009 as compared to 2008 were a favorable sales mix toward products with higher gross margins and lower commodity and other product costs, which were partially offset by product price reductions.

The gross margin percentage in 2008 was 35.2% compared to 33.2% in 2007. The primary contributors of the increase in 2008 as compared to 2007 were a favorable sales mix toward products with higher gross margins and lower commodity costs, which were partially offset by higher other product costs. In 2007, gross margin was impacted by higher than expected costs associated with the initial iPhone product launch.

## Operating Expenses

Operating expenses for the three years ended September 26, 2009, are as follows (in millions, except for percentages):

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Research and development	\$ 1,333	\$ 1,109	\$ 782
Percentage of net sales	3.1%	3.0%	3.2%
Selling, general and administrative	\$ 4,149	\$ 3,761	\$ 2,963
Percentage of net sales	9.7%	10.0%	12.1%

## Research and Development ("R&D")

R&D expenditures increased 20% or \$224 million to \$1.3 billion in 2009 compared to 2008. These increases were due primarily to an increase in headcount in the current year to support expanded R&D activities and higher stock-based compensation expenses. In addition, \$71 million of software development costs were capitalized related to Mac OS X Snow Leopard and excluded from R&D expense during 2009, compared to \$11 million of software development costs capitalized during 2008. Although total R&D expense increased 20% during 2009, it remained relatively flat as a percentage of net sales given the 14% increase in revenue in 2009. The Company continues to believe that focused investments in R&D are critical to its future growth and competitive position in the marketplace and are directly related to timely development of new and enhanced products that are central to the Company's core business strategy. As such, the Company expects to make further investments in R&D to remain competitive.

Expenditures for R&D increased 42% or \$327 million to \$1.1 billion in 2008 compared to 2007. These increases were due primarily to an increase in headcount in 2008 and higher stock-based compensation expenses. In 2008, \$11 million of software development costs were capitalized related to Mac OS X Snow Leopard and excluded

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from R&D expense, while R&D expense for 2007 excluded \$75 million of capitalized software development costs related to Mac OS X Leopard and iPhone software. Although total R&D expense increased 42% during 2008, it remained relatively flat as a percentage of net sales given the 53% increase in revenue during 2008.

### *Selling, General and Administrative Expense ("SG&A")*

SG&A expenditures increased \$388 million or 10% to \$4.1 billion in 2009 compared to 2008. These increases are due primarily to the Company's continued expansion of its Retail segment in both domestic and international markets, higher stock-based compensation expenses and higher spending on marketing and advertising.

Expenditures for SG&A increased \$798 million or 27% to \$3.8 billion in 2008 compared to 2007. These increases are due primarily to higher stock-based compensation expenses, higher variable selling expenses resulting from the significant year-over-year increase in total net sales and the Company's continued expansion of its Retail segment in both domestic and international markets. In addition, the Company incurred higher spending on marketing and advertising during 2008 compared to 2007.

### **Other Income and Expense**

Other income and expense for the three years ended September 26, 2009, are as follows (in millions):

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Interest income	\$407	\$653	\$647
Other income (expense), net	(81)	(33)	(48)
Total other income and expense	<u>\$326</u>	<u>\$620</u>	<u>\$599</u>

Total other income and expense decreased \$294 million or 47% to \$326 million during 2009 compared to \$620 million and \$599 million in 2008 and 2007, respectively. The overall decrease in other income and expense is attributable to the significant decline in interest rates during 2009 compared to 2008 and 2007, partially offset by the Company's higher cash, cash equivalents and marketable securities balances. The weighted average interest rate earned by the Company on its cash, cash equivalents and marketable securities was 1.43%, 3.44% and 5.27% during 2009, 2008 and 2007, respectively. During 2009, 2008 and 2007, the Company had no debt outstanding and accordingly did not incur any related interest expense.

The Company's investment portfolio had gross unrealized losses of \$16 million and \$121 million as of September 26, 2009 and September 27, 2008, respectively, which were offset by gross unrealized gains of \$73 million and \$4 million as of September 26, 2009 and September 27, 2008, respectively. The net unrealized gains as of September 26, 2009 and the net unrealized losses as of September 27, 2008 related primarily to long-term marketable securities. The Company considers the declines in market value of its marketable securities investment portfolio to be temporary in nature. The unrealized losses on the Company's marketable securities were caused primarily by changes in market interest rates, specifically widening credit spreads. The Company does not have the intent to sell, nor is it more likely than not the Company will be required to sell, any investment before recovery of its amortized cost basis. Accordingly, no material declines in fair value were recognized in the Company's Consolidated Statements of Operations during 2009, 2008 and 2007. The Company may sell certain of its marketable securities prior to their stated maturities for strategic purposes, in anticipation of credit deterioration, or for duration management. The Company recognized no material net gains or losses during 2009, 2008 and 2007 related to such sales.

### **Provision for Income Taxes**

The Company's effective tax rates were 32%, 32% and 30% for 2009, 2008 and 2007, respectively. The Company's effective rates for these periods differ from the statutory federal income tax rate of 35% due primarily to certain undistributed foreign earnings for which no U.S. taxes are provided because such earnings are intended to be indefinitely reinvested outside the U.S.



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### Liquidity and Capital Resources

The following table presents selected financial information and statistics as of and for the three years ended September 26, 2009 (in millions):

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Cash, cash equivalents and marketable securities	\$33,992	\$24,490	\$15,386
Accounts receivable, net	\$ 3,361	\$ 2,422	\$ 1,637
Inventories	\$ 455	\$ 509	\$ 346
Working capital	\$20,049	\$18,645	\$12,595
Annual operating cash flow	\$10,159	\$ 9,596	\$ 5,470

As of September 26, 2009, the Company had \$34.0 billion in cash, cash equivalents and marketable securities, an increase of \$9.5 billion from September 27, 2008. The principal component of this net increase was the cash generated by operating activities of \$10.2 billion, which was partially offset by payments for acquisitions of property, plant and equipment of \$1.1 billion.

The Company's marketable securities investment portfolio is invested primarily in highly rated securities, generally with a minimum rating of single-A or equivalent. As of September 26, 2009 and September 27, 2008, \$17.4 billion and \$11.3 billion, respectively, of the Company's cash, cash equivalents and marketable securities were held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings. The Company believes its existing balances of cash, cash equivalents and marketable securities will be sufficient to satisfy its working capital needs, capital asset purchases, outstanding commitments and other liquidity requirements associated with its existing operations over the next 12 months.

#### Capital Assets

The Company's cash payments for capital asset purchases were \$1.1 billion during 2009, consisting of \$369 million for retail store facilities and \$775 million for real estate acquisitions and corporate infrastructure including information systems enhancements. The Company anticipates utilizing approximately \$1.9 billion for capital asset purchases during 2010, including approximately \$400 million for Retail facilities and approximately \$1.5 billion for corporate facilities, infrastructure, and product tooling and manufacturing process equipment.

Historically the Company has opened between 25 and 50 new retail stores per year. During 2010, the Company expects to open a number of new stores near the upper end of this range, over half of which are expected to be located outside of the U.S.

#### Off-Balance Sheet Arrangements and Contractual Obligations

The Company has not entered into any transactions with unconsolidated entities whereby the Company has financial guarantees, subordinated retained interests, derivative instruments, or other contingent arrangements that expose the Company to material continuing risks, contingent liabilities, or any other obligation under a variable interest in an unconsolidated entity that provides financing, liquidity, market risk, or credit risk support to the Company.

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**CONSOLIDATED STATEMENTS OF OPERATIONS**

(in millions, except share amounts which are reflected in thousands and per share amounts)

<u>Three years ended September 26, 2009</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Net sales	\$ 42,905	\$ 37,491	\$ 24,578
Cost of sales	25,683	24,294	16,426
Gross margin	<u>17,222</u>	<u>13,197</u>	<u>8,152</u>
Operating expenses:			
Research and development	1,333	1,109	782
Selling, general and administrative	4,149	3,761	2,963
Total operating expenses	<u>5,482</u>	<u>4,870</u>	<u>3,745</u>
Operating income	11,740	8,327	4,407
Other income and expense	326	620	599
Income before provision for income taxes	12,066	8,947	5,006
Provision for income taxes	3,831	2,828	1,511
Net income	<u>\$ 8,235</u>	<u>\$ 6,119</u>	<u>\$ 3,495</u>
Earnings per common share:			
Basic	\$ 9.22	\$ 6.94	\$ 4.04
Diluted	\$ 9.08	\$ 6.78	\$ 3.93
Shares used in computing earnings per share:			
Basic	893,016	881,592	864,595
Diluted	907,005	902,139	889,292

See accompanying Notes to Consolidated Financial Statements.

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### Note 7 – Income Taxes

The provision for income taxes for the three years ended September 26, 2009, consisted of the following (in millions):

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Federal:			
Current	\$2,166	\$1,945	\$1,223
Deferred	<u>1,077</u>	<u>498</u>	<u>80</u>
	<u>3,243</u>	<u>2,443</u>	<u>1,303</u>
State:			
Current	280	210	112
Deferred	<u>(2)</u>	<u>(25)</u>	<u>9</u>
	<u>278</u>	<u>185</u>	<u>121</u>
Foreign:			
Current	345	275	103
Deferred	<u>(35)</u>	<u>(75)</u>	<u>(16)</u>
	<u>310</u>	<u>200</u>	<u>87</u>
Provision for income taxes	<u>\$3,831</u>	<u>\$2,828</u>	<u>\$1,511</u>

The foreign provision for income taxes is based on foreign pretax earnings of \$6.6 billion, \$4.6 billion and \$2.2 billion in 2009, 2008 and 2007, respectively. As of September 26, 2009 and September 27, 2008, \$17.4 billion and \$11.3 billion, respectively, of the Company's cash, cash equivalents and marketable securities were held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings. Amounts held by foreign subsidiaries are generally subject to U.S. income taxation on repatriation to the U.S. The Company's consolidated financial statements provide for any related tax liability on amounts that may be repatriated, aside from undistributed earnings of certain of the Company's foreign subsidiaries that are intended to be indefinitely reinvested in operations outside the U.S. U.S. income taxes have not been provided on a cumulative total of \$5.1 billion of such earnings. It is not practicable to determine the income tax liability that might be incurred if these earnings were to be distributed.

Deferred tax assets and liabilities reflect the effects of tax losses, credits, and the future income tax effects of temporary differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases and are measured using enacted tax rates that apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

As of September 26, 2009 and September 27, 2008, the significant components of the Company's deferred tax assets and liabilities were (in millions):

	<u>2009</u>	<u>2008</u>
Deferred tax assets:		
Accrued liabilities and other reserves	\$1,030	\$1,003
Basis of capital assets and investments	180	173
Accounts receivable and inventory reserves	172	126
Other	<u>470</u>	<u>415</u>
Total deferred tax assets	<u>1,852</u>	<u>1,717</u>
Less valuation allowance	<u>—</u>	<u>—</u>
Deferred tax assets, net of valuation allowance	<u>1,852</u>	<u>1,717</u>
Deferred tax liabilities - Unremitted earnings of foreign subsidiaries	<u>2,774</u>	<u>1,569</u>
Net deferred tax (liabilities)/assets	<u>\$ (922)</u>	<u>\$ 148</u>

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- (a) The Americas asset figures do not include fixed assets held in the U.S. Such fixed assets are not allocated specifically to the Americas segment and are included in the corporate assets figures below.
- (b) Retail segment depreciation and asset figures reflect the cost and related depreciation of its retail stores and related infrastructure.
- (c) Other Segments include Asia-Pacific and FileMaker.

A reconciliation of the Company's segment operating income and assets to the consolidated financial statements for the three years ended September 26, 2009 is as follows (in millions):

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Segment operating income	\$14,692	\$10,881	\$ 5,846
Other corporate expenses, net (a)	(2,242)	(2,038)	(1,197)
Stock-based compensation expense	(710)	(516)	(242)
Total operating income	<u>\$11,740</u>	<u>\$ 8,327</u>	<u>\$ 4,407</u>
Segment assets	\$ 5,604	\$ 4,563	\$ 3,151
Corporate assets	41,897	31,608	21,727
Consolidated assets	<u>\$47,501</u>	<u>\$36,171</u>	<u>\$24,878</u>
Segment depreciation, amortization and accretion	\$ 170	\$ 129	\$ 109
Corporate depreciation, amortization and accretion	564	367	218
Consolidated depreciation, amortization and accretion	<u>\$ 734</u>	<u>\$ 496</u>	<u>\$ 327</u>

- (a) Other corporate expenses include research and development, corporate marketing expenses, manufacturing costs and variances not included in standard costs, and other separately managed general and administrative expenses, including certain corporate expenses associated with support of the Retail segment.

No single country outside of the U.S. accounted for more than 10% of net sales in 2009, 2008 or 2007. One of the Company's customers accounted for 11% of net sales in 2009; there was no single customer that accounted for more than 10% of net sales in 2008 or 2007. Net sales and long-lived assets related to the U.S. and international operations for the three years ended September 26, 2009, are as follows (in millions):

	<u>2009</u>	<u>2008</u>	<u>2007</u>
Net sales:			
U.S.	\$22,325	\$20,893	\$14,683
International	20,580	16,598	9,895
Total net sales	<u>\$42,905</u>	<u>\$37,491</u>	<u>\$24,578</u>
Long-lived assets:			
U.S.	\$ 2,698	\$ 2,269	\$ 1,752
International	495	410	260
Total long-lived assets	<u>\$ 3,193</u>	<u>\$ 2,679</u>	<u>\$ 2,012</u>

# APPLE INC

## FORM 10-K (Annual Report)

Filed 10/27/10 for the Period Ending 09/25/10

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CIK	0000320193
Symbol	AAPL
SIC Code	3571 - Electronic Computers
Industry	Computer Hardware
Sector	Technology
Fiscal Year	09/30

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**Item 6. Selected Financial Data**

The information set forth below for the five years ended September 25, 2010, is not necessarily indicative of results of future operations, and should be read in conjunction with Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the consolidated financial statements and related notes thereto included in Item 8 of this Form 10-K to fully understand factors that may affect the comparability of the information presented below (in millions, except share amounts which are reflected in thousands and per share amounts).

	2010	2009	2008	2007	2006
Net sales	\$ 65,225	\$ 42,905	\$ 37,491	\$ 24,578	\$ 19,315
Net income	\$ 14,013	\$ 8,235	\$ 6,119	\$ 3,495	\$ 1,989
Earnings per common share:					
Basic	\$ 15.41	\$ 9.22	\$ 6.94	\$ 4.04	\$ 2.36
Diluted	\$ 15.15	\$ 9.08	\$ 6.78	\$ 3.93	\$ 2.27
Cash dividends declared per common share	\$ 0	\$ 0	\$ 0	\$ 0	\$ 0
Shares used in computing earnings per share:					
Basic	909,461	893,016	881,592	864,595	844,058
Diluted	924,712	907,005	902,139	889,292	877,526
Total cash, cash equivalents and marketable securities	\$ 51,011	\$ 33,992	\$ 24,490	\$ 15,386	\$ 10,110
Total assets	\$ 75,183	\$ 47,501	\$ 36,171	\$ 24,878	\$ 17,205
Total long-term obligations (a)	\$ 5,531	\$ 3,502	\$ 1,745	\$ 687	\$ 395
Total liabilities	\$ 27,392	\$ 15,861	\$ 13,874	\$ 10,347	\$ 7,221
Total shareholders' equity	\$ 47,791	\$ 31,640	\$ 22,297	\$ 14,531	\$ 9,984

(a) The Company did not have any long-term debt during the five years ended September 25, 2010. Long-term obligations excludes non-current deferred revenue.

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### Gross Margin

Gross margin for the three years ended September 25, 2010, are as follows (in millions, except gross margin percentages):

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Net sales	\$65,225	\$42,905	\$37,491
Cost of sales	<u>39,541</u>	<u>25,683</u>	<u>24,294</u>
Gross margin	<u>\$25,684</u>	<u>\$17,222</u>	<u>\$13,197</u>
Gross margin percentage	39.4%	40.1%	35.2%

The gross margin percentage in 2010 was 39.4% compared to 40.1% in 2009. This decline in gross margin is primarily attributable to new products that have higher cost structures, including iPad, partially offset by a more favorable sales mix of iPhone, which has a higher gross margin than the Company average.

The gross margin percentage in 2009 was 40.1% compared to 35.2% in 2008. The primary contributors to the increase in 2009 as compared to 2008 were a favorable sales mix toward products with higher gross margins and lower commodity and other product costs, which were partially offset by product price reductions.

The Company expects its gross margin percentage to decrease in future periods compared to levels achieved during 2010 and anticipates gross margin levels of about 36% in the first quarter of 2011. This expected decline is largely due to a higher mix of new and innovative products that have higher cost structures and deliver greater value to customers, and expected and potential future component cost and other cost increases.

The foregoing statements regarding the Company's expected gross margin percentage are forward-looking and could differ from anticipated levels because of several factors, including but not limited to certain of those set forth below in Part I, Item 1A, "Risk Factors" under the subheading "*Future operating results depend upon the Company's ability to obtain key components including but not limited to microprocessors, NAND flash memory, DRAM and LCDs at favorable prices and in sufficient quantities*," which is incorporated herein by reference. There can be no assurance that targeted gross margin percentage levels will be achieved. In general, gross margins and margins on individual products will remain under downward pressure due to a variety of factors, including continued industry wide global product pricing pressures, increased competition, compressed product life cycles, product transitions and expected and potential increases in the cost of key components including but not limited to microprocessors, NAND flash memory, DRAM and LCDs, as well as potential increases in the costs of outside manufacturing services and a potential shift in the Company's sales mix towards products with lower gross margins. In response to these competitive pressures, the Company expects it will continue to take product pricing actions, which would adversely affect gross margins. Gross margins could also be affected by the Company's ability to manage product quality and warranty costs effectively and to stimulate demand for certain of its products. Due to the Company's significant international operations, financial results can be significantly affected in the short-term by fluctuations in exchange rates.

### Operating Expenses

Operating expenses for the three years ended September 25, 2010, are as follows (in millions, except for percentages):

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Research and development	\$ 1,782	\$ 1,333	\$ 1,109
Percentage of net sales	2.7%	3.1%	3.0%
Selling, general and administrative	\$ 5,517	\$ 4,149	\$ 3,761
Percentage of net sales	8.5%	9.7%	10.0%

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### Research and Development Expense ("R&D")

R&D expense increased 34% or \$449 million to \$1.8 billion in 2010 compared to 2009. This increase was due primarily to an increase in headcount and related expenses in the current year to support expanded R&D activities. Also contributing to this increase in R&D expense in 2010 was the capitalization in 2009 of software development costs of \$71 million related to Mac OS X Snow Leopard. Although total R&D expense increased 34% during 2010, it declined as a percentage of net sales given the 52% year-over-year increase in net sales in 2010. The Company continues to believe that focused investments in R&D are critical to its future growth and competitive position in the marketplace and are directly related to timely development of new and enhanced products that are central to the Company's core business strategy. As such, the Company expects to make further investments in R&D to remain competitive.

R&D expense increased 20% or \$224 million to \$1.3 billion in 2009 compared to 2008. This increase was due primarily to an increase in headcount in 2009 to support expanded R&D activities and higher stock-based compensation expenses. Additionally, \$71 million of software development costs were capitalized related to Mac OS X Snow Leopard and excluded from R&D expense during 2009, compared to \$11 million of software development costs capitalized during 2008. Although total R&D expense increased 20% during 2009, it remained relatively flat as a percentage of net sales given the 14% increase in revenue in 2009.

### Selling, General and Administrative Expense ("SG&A")

SG&A expense increased \$1.4 billion or 33% to \$5.5 billion in 2010 compared to 2009. This increase was due primarily to the Company's continued expansion of its Retail segment, higher spending on marketing and advertising programs, increased stock-based compensation expenses and variable costs associated with the overall growth of the Company's net sales.

SG&A expenses increased \$388 million or 10% to \$4.1 billion in 2009 compared to 2008. This increase was due primarily to the Company's continued expansion of its Retail segment in both domestic and international markets, higher stock-based compensation expense and higher spending on marketing and advertising.

### Other Income and Expense

Other income and expense for the three years ended September 25, 2010, are as follows (in millions):

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Interest income	\$ 311	\$ 407	\$ 653
Other income (expense), net	(156)	(81)	(33)
Total other income and expense	<u>\$ 155</u>	<u>\$ 326</u>	<u>\$ 620</u>

Total other income and expense decreased \$171 million or 52% to \$155 million during 2010 compared to \$326 million and \$620 million in 2009 and 2008, respectively. The overall decrease in other income and expense is attributable to the significant declines in interest rates on a year-over-year basis, partially offset by the Company's higher cash, cash equivalents and marketable securities balances. The weighted average interest rate earned by the Company on its cash, cash equivalents and marketable securities was 0.75%, 1.43% and 3.44% during 2010, 2009 and 2008, respectively. Additionally the Company incurred higher premium expenses on its foreign exchange option contracts, which further reduced the total other income and expense. During 2010, 2009 and 2008, the Company had no debt outstanding and accordingly did not incur any related interest expense.

### Provision for Income Taxes

The Company's effective tax rates were 24%, 32% and 32% for 2010, 2009 and 2008, respectively. The Company's effective rates for these periods differ from the statutory federal income tax rate of 35% due



**Table of Contents****CONSOLIDATED STATEMENTS OF OPERATIONS**

(In millions, except share amounts which are reflected in thousands and per share amounts)

<u>Three years ended September 25, 2010</u>	<u>2010</u>	<u>2009</u>	<u>2008</u>
Net sales	\$ 65,225	\$ 42,905	\$ 37,491
Cost of sales	<u>39,541</u>	<u>25,683</u>	<u>24,294</u>
Gross margin	<u>25,684</u>	<u>17,222</u>	<u>13,197</u>
Operating expenses:			
Research and development	1,782	1,333	1,109
Selling, general and administrative	<u>5,517</u>	<u>4,149</u>	<u>3,761</u>
Total operating expenses	<u>7,299</u>	<u>5,482</u>	<u>4,870</u>
Operating income	18,385	11,740	8,327
Other income and expense	<u>155</u>	<u>326</u>	<u>620</u>
Income before provision for income taxes	18,540	12,066	8,947
Provision for income taxes	<u>4,527</u>	<u>3,831</u>	<u>2,828</u>
Net income	<u>\$ 14,013</u>	<u>\$ 8,235</u>	<u>\$ 6,119</u>
Earnings per common share:			
Basic	\$ 15.41	\$ 9.22	\$ 6.94
Diluted	\$ 15.15	\$ 9.08	\$ 6.78
Shares used in computing earnings per share:			
Basic	909,461	893,016	881,592
Diluted	924,712	907,005	902,139

See accompanying Notes to Consolidated Financial Statements.

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### Note 6 – Income Taxes

The provision for income taxes for the three years ended September 25, 2010, consisted of the following (in millions):

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Federal:			
Current	\$2,150	\$1,922	\$1,796
Deferred	<u>1,676</u>	<u>1,077</u>	<u>498</u>
	<u>3,826</u>	<u>2,999</u>	<u>2,294</u>
State:			
Current	655	524	359
Deferred	<u>(115)</u>	<u>(2)</u>	<u>(25)</u>
	<u>540</u>	<u>522</u>	<u>334</u>
Foreign:			
Current	282	345	275
Deferred	<u>(121)</u>	<u>(35)</u>	<u>(75)</u>
	<u>161</u>	<u>310</u>	<u>200</u>
Provision for income taxes	<u>\$4,527</u>	<u>\$3,831</u>	<u>\$2,828</u>

The foreign provision for income taxes is based on foreign pretax earnings of \$13.0 billion, \$6.6 billion and \$4.6 billion in 2010, 2009 and 2008, respectively. The Company's consolidated financial statements provide for any related tax liability on amounts that may be repatriated, aside from undistributed earnings of certain of the Company's foreign subsidiaries that are intended to be indefinitely reinvested in operations outside the U.S. As of September 25, 2010, U.S. income taxes have not been provided on a cumulative total of \$12.3 billion of such earnings. The amount of unrecognized deferred tax liability related to these temporary differences is estimated to be approximately \$4.0 billion.

As of September 25, 2010 and September 26, 2009, \$30.8 billion and \$17.4 billion, respectively, of the Company's cash, cash equivalents and marketable securities were held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings. Amounts held by foreign subsidiaries are generally subject to U.S. income taxation on repatriation to the U.S.

Deferred tax assets and liabilities reflect the effects of tax losses, credits, and the future income tax effects of temporary differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases and are measured using enacted tax rates that apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

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(a) Other corporate expenses include research and development, corporate marketing expenses, manufacturing costs and variances not included in standard costs, and other separately managed general and administrative expenses, including certain corporate expenses associated with support of the Retail segment.

No single country outside of the U.S. accounted for more than 10% of net sales in 2010, 2009 or 2008. One of the Company's customers accounted for 11% of net sales in 2009; there was no single customer that accounted for more than 10% of net sales in 2010 or 2008. Net sales and long-lived assets related to the U.S. and international operations for the three years ended September 25, 2010, are as follows (in millions):

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Net sales:			
U.S.	\$28,633	\$22,325	\$20,893
International	<u>36,592</u>	<u>20,580</u>	<u>16,598</u>
Total net sales	<u>\$65,225</u>	<u>\$42,905</u>	<u>\$37,491</u>
Long-lived assets:			
U.S.	\$ 4,292	\$ 2,698	\$ 2,269
International	<u>710</u>	<u>495</u>	<u>410</u>
Total long-lived assets	<u>\$ 5,002</u>	<u>\$ 3,193</u>	<u>\$ 2,679</u>

Information regarding net sales by product for the three years ended September 25, 2010, is as follows (in millions):

	<u>2010</u>	<u>2009</u>	<u>2008</u>
Desktops (a)	\$ 6,201	\$ 4,324	\$ 5,622
Portables (b)	<u>11,278</u>	<u>9,535</u>	<u>8,732</u>
Total Mac net sales	17,479	13,859	14,354
iPod	8,274	8,091	9,153
Other music related products and services (c)	4,948	4,036	3,340
iPhone and related products and services (d)	25,179	13,033	6,742
iPad and related products and services (e)	4,958	0	0
Peripherals and other hardware (f)	1,814	1,475	1,694
Software, service and other net sales (g)	<u>2,573</u>	<u>2,411</u>	<u>2,208</u>
Total net sales	<u>\$65,225</u>	<u>\$42,905</u>	<u>\$37,491</u>

(a) Includes iMac, Mac mini, Mac Pro and Xserve product lines.

(b) Includes MacBook, MacBook Air and MacBook Pro product lines.

(c) Includes iTunes Store sales, iPod services, and Apple-branded and third-party iPod accessories.

(d) Includes revenue recognized from iPhone sales, carrier agreements, services, and Apple-branded and third-party iPhone accessories.

(e) Includes revenue recognized from iPad sales, services and Apple-branded and third-party iPad accessories.

(f) Includes sales of displays, wireless connectivity and networking solutions, and other hardware accessories.

(g) Includes sales of Apple-branded operating system and application software, third-party software, Mac and Internet services.

### Note 10 – Related Party Transactions and Certain Other Transactions

The Company entered into a Reimbursement Agreement with its CEO, Steve Jobs, for the reimbursement of expenses incurred by Mr. Jobs in the operation of his private plane when used for Apple business. The Company recognized a total of approximately \$248,000, \$4,000 and \$871,000 in expenses pursuant to the Reimbursement

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**Form 10-K**

(Mark One)

 ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended September 24, 2011

Or

 TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number: 000-10030

**APPLE INC.**

(Exact name of registrant as specified in its charter)

California  
(State or other jurisdiction of incorporation or organization)94-2404110  
(I.R.S. Employer Identification No.)1 Infinite Loop  
Cupertino, California  
(Address of principal executive offices)95014  
(Zip Code)

Registrant's telephone number, including area code: (408) 996-1010

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, no par value  
(Title of class)The NASDAQ Global Select Market  
(Name of exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No 

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes  No 

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No 

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. 

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer Non-accelerated filer  (Do not check if smaller reporting company)Smaller Reporting Company 

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes  No 

The aggregate market value of the voting and non-voting stock held by non-affiliates of the registrant, as of March 25, 2011, the last business day of the Company's most recently completed second fiscal quarter, was approximately \$322,921,000,000 based upon the closing price reported for such date on the NASDAQ Global Select Market. For purposes of this disclosure, shares of common stock held by persons who hold more than 5% of the outstanding shares of common stock and shares held by executive officers and directors of the registrant have been excluded because such persons may be deemed to be affiliates. This determination of executive officer or affiliate status is not necessarily a conclusive determination for other purposes.

929,409,000 shares of Common Stock Issued and Outstanding as of October 14, 2011

**DOCUMENTS INCORPORATED BY REFERENCE**

(1) Portions of the registrant's definitive Proxy Statement relating to its 2012 Annual Meeting of Shareholders are incorporated by reference into Part III of this Annual Report on Form 10-K where indicated. Such Proxy Statement will be filed with the U.S. Securities and Exchange Commission within 120 days after the end of the fiscal year to which this report relates.

## Gross Margin

Gross margin for the three years ended September 24, 2011, are as follows (in millions, except gross margin percentages):

	2011	2010	2009
Net sales .....	\$108,249	\$ 65,225	\$ 42,905
Cost of sales .....	64,431	39,541	25,683
Gross margin .....	<u>\$ 43,818</u>	<u>\$ 25,684</u>	<u>\$ 17,222</u>
Gross margin percentage .....	40.5%	39.4%	40.1%

The gross margin percentage in 2011 was 40.5%, compared to 39.4% in 2010. This year-over-year increase in gross margin was largely driven by lower commodity and other product costs.

The gross margin percentage in 2010 was 39.4% compared to 40.1% in 2009. This year-over-year decline in gross margin was primarily attributable to new products that had higher cost structures, including iPad, partially offset by a more favorable sales mix of iPhone, which had a higher gross margin than the Company average.

The Company expects to experience decreases in its gross margin percentage in future periods, as compared to levels achieved during 2011, largely due to a higher mix of new and innovative products with flat or reduced pricing that have higher cost structures and deliver greater value to customers, and potential future component cost and other cost increases.

The foregoing statements regarding the Company's expected gross margin percentage are forward-looking and could differ from anticipated levels because of several factors including, but not limited to certain of those set forth below in Part I, Item 1A, "Risk Factors" under the subheading "*Future operating results depend upon the Company's ability to obtain components in sufficient quantities,*" which is incorporated herein by reference. In general, gross margins and margins on individual products will remain under downward pressure due to a variety of factors, including continued industry wide global product pricing pressures, increased competition, compressed product life cycles, product transitions and potential increases in the cost of components, as well as potential increases in the costs of outside manufacturing services and a potential shift in the Company's sales mix towards products with lower gross margins. In response to these competitive pressures, the Company expects it will continue to take product pricing actions, which would adversely affect gross margins. Gross margins could also be affected by the Company's ability to manage product quality and warranty costs effectively and to stimulate demand for certain of its products. Due to the Company's significant international operations, financial results can be significantly affected in the short-term by fluctuations in exchange rates.

## Operating Expenses

Operating expenses for the three years ended September 24, 2011, are as follows (in millions, except for percentages):

	2011	2010	2009
Research and development .....	\$ 2,429	\$ 1,782	\$ 1,333
Percentage of net sales .....	2%	3%	3%
Selling, general and administrative .....	\$ 7,599	\$ 5,517	\$ 4,149
Percentage of net sales .....	7%	8%	10%

### *Research and Development Expense ("R&D")*

R&D expense increased \$647 million or 36% to \$2.4 billion in 2011 compared to 2010. This increase was due primarily to an increase in headcount and related expenses to support expanded R&D activities. Although total

R&D expense increased 36% during 2011 compared to 2010, it declined slightly as a percentage of net sales, due to the 66% year-over-year growth in the Company's net sales during 2011.

R&D expense increased 34% or \$449 million to \$1.8 billion in 2010 compared to 2009. This increase was due primarily to an increase in headcount and related expenses in the current year to support expanded R&D activities. Also contributing to this increase in R&D expense in 2010 was the capitalization in 2009 of software development costs of \$71 million related to Mac OS X Snow Leopard. Although total R&D expense increased 34% during 2010, it declined as a percentage of net sales given the 52% year-over-year increase in net sales in 2010.

The Company continues to believe that focused investments in R&D are critical to its future growth and competitive position in the marketplace and are directly related to timely development of new and enhanced products that are central to the Company's core business strategy. As such, the Company expects to make further investments in R&D to remain competitive.

#### *Selling, General and Administrative Expense ("SG&A")*

SG&A expense increased \$2.1 billion or 38% to \$7.6 billion during 2011 compared to 2010. This increase was due primarily to the Company's continued expansion of its Retail segment, increased headcount and related costs, higher spending on professional services and marketing and advertising programs, and increased variable costs associated with the overall growth of the Company's net sales.

SG&A expense increased \$1.4 billion or 33% to \$5.5 billion in 2010 compared to 2009. This increase was due primarily to the Company's continued expansion of its Retail segment, higher spending on marketing and advertising programs, increased share-based compensation expenses and variable costs associated with the overall growth of the Company's net sales.

#### **Other Income and Expense**

Other income and expense for the three years ended September 24, 2011, are as follows (in millions):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Interest and dividend income .....	\$ 519	\$ 311	\$ 407
Other expense, net .....	(104)	(156)	(81)
Total other income and expense .....	<u>\$ 415</u>	<u>\$ 155</u>	<u>\$ 326</u>

Total other income and expense increased \$260 million or 168% to \$415 million during 2011 compared to \$155 million and \$326 million in 2010 and 2009, respectively. The year-over-year increase in other income and expense during 2011 was due primarily to higher interest income and net realized gains on sales of marketable securities. The overall decrease in other income and expense in 2010 compared to 2009 was attributable to the significant declines in interest rates on a year-over-year basis, partially offset by the Company's higher cash, cash equivalents and marketable securities balances. Additionally the Company incurred higher premium expenses on its foreign exchange option contracts, which further reduced the total other income and expense. The weighted average interest rate earned by the Company on its cash, cash equivalents and marketable securities was 0.77%, 0.75% and 1.43% during 2011, 2010 and 2009, respectively. During 2011, 2010 and 2009, the Company had no debt outstanding and accordingly did not incur any related interest expense.

#### **Provision for Income Taxes**

The Company's effective tax rates were approximately 24.2%, 24.4% and 31.8% for 2011, 2010 and 2009, respectively. The Company's effective rates for these periods differ from the statutory federal income tax rate of

35% due primarily to certain undistributed foreign earnings for which no U.S. taxes are provided because such earnings are intended to be indefinitely reinvested outside the U.S.

As of September 24, 2011, the Company had deferred tax assets arising from deductible temporary differences, tax losses, and tax credits of \$3.2 billion, and deferred tax liabilities of \$9.2 billion. Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with future reversals of existing taxable temporary differences, will be sufficient to fully recover the deferred tax assets. The Company will continue to evaluate the realizability of deferred tax assets quarterly by assessing the need for and amount of a valuation allowance.

The Internal Revenue Service (the "IRS") has completed its field audit of the Company's federal income tax returns for the years 2004 through 2006 and proposed certain adjustments. The Company has contested certain of these adjustments through the IRS Appeals Office. The IRS is currently examining the years 2007 through 2009. All IRS audit issues for years prior to 2004 have been resolved. In addition, the Company is subject to audits by state, local, and foreign tax authorities. Management believes that adequate provisions have been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company's tax audits are resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income taxes in the period such resolution occurs.

#### Liquidity and Capital Resources

The following table presents selected financial information and statistics as of and for the three years ended September 24, 2011 (in millions):

	2011	2010	2009
Cash, cash equivalents and marketable securities .....	\$81,570	\$51,011	\$33,992
Accounts receivable, net .....	\$ 5,369	\$ 5,510	\$ 3,361
Inventories .....	\$ 776	\$ 1,051	\$ 455
Working capital .....	\$17,018	\$20,956	\$20,049
Annual operating cash flow .....	\$37,529	\$18,595	\$10,159

Cash, cash equivalents and marketable securities increased \$30.6 billion or 60% during 2011. The principal components of this net increase was the cash generated by operating activities of \$37.5 billion, which was partially offset by payments for acquisition of property, plant and equipment of \$4.3 billion, payments for acquisition of intangible assets of \$3.2 billion and payments made in connection with business acquisitions, net of cash acquired, of \$244 million. The Company believes its existing balances of cash, cash equivalents and marketable securities will be sufficient to satisfy its working capital needs, capital asset purchases, outstanding commitments and other liquidity requirements associated with its existing operations over the next 12 months.

The Company's marketable securities investment portfolio is invested primarily in highly rated securities and its policy generally limits the amount of credit exposure to any one issuer. The Company's investment policy requires investments to generally be investment grade with the objective of minimizing the potential risk of principal loss. As of September 24, 2011 and September 25, 2010, \$54.3 billion and \$30.8 billion, respectively, of the Company's cash, cash equivalents and marketable securities were held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings. Amounts held by foreign subsidiaries are generally subject to U.S. income taxation on repatriation to the U.S.

#### Capital Assets

The Company's capital expenditures were \$4.6 billion during 2011, consisting of approximately \$614 million for retail store facilities and \$4.0 billion for other capital expenditures, including product tooling and manufacturing

## CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions, except number of shares which are reflected in thousands and per share amounts)

<u>Three years ended September 24, 2011</u>	<u>2011</u>	<u>2010</u>	<u>2009</u>
Net sales .....	\$108,249	\$ 65,225	\$ 42,905
Cost of sales .....	64,431	39,541	25,683
Gross margin .....	43,818	25,684	17,222
Operating expenses:			
Research and development .....	2,429	1,782	1,333
Selling, general and administrative .....	7,599	5,517	4,149
Total operating expenses .....	10,028	7,299	5,482
Operating income .....	33,790	18,385	11,740
Other income and expense .....	415	155	326
Income before provision for income taxes .....	34,205	18,540	12,066
Provision for income taxes .....	8,283	4,527	3,831
Net income .....	<u>\$ 25,922</u>	<u>\$ 14,013</u>	<u>\$ 8,235</u>
Earnings per common share:			
Basic .....	\$ 28.05	\$ 15.41	\$ 9.22
Diluted .....	\$ 27.68	\$ 15.15	\$ 9.08
Shares used in computing earnings per share:			
Basic .....	924,258	909,461	893,016
Diluted .....	936,645	924,712	907,005

See accompanying Notes to Consolidated Financial Statements.



**Note 5 – Income Taxes**

The provision for income taxes for the three years ended September 24, 2011, consisted of the following (in millions):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Federal:			
Current .....	\$3,884	\$2,150	\$1,922
Deferred .....	2,998	1,676	1,077
	<u>6,882</u>	<u>3,826</u>	<u>2,999</u>
State:			
Current .....	762	655	524
Deferred .....	37	(115)	(2)
	<u>799</u>	<u>540</u>	<u>522</u>
Foreign:			
Current .....	769	282	345
Deferred .....	(167)	(121)	(35)
	<u>602</u>	<u>161</u>	<u>310</u>
Provision for income taxes .....	<u>\$8,283</u>	<u>\$4,527</u>	<u>\$3,831</u>

The foreign provision for income taxes is based on foreign pretax earnings of \$24.0 billion, \$13.0 billion and \$6.6 billion in 2011, 2010 and 2009, respectively. The Company's consolidated financial statements provide for any related tax liability on amounts that may be repatriated, aside from undistributed earnings of certain of the Company's foreign subsidiaries that are intended to be indefinitely reinvested in operations outside the U.S. As of September 24, 2011, U.S. income taxes have not been provided on a cumulative total of \$23.4 billion of such earnings. The amount of unrecognized deferred tax liability related to these temporary differences is estimated to be approximately \$8.0 billion.

As of September 24, 2011 and September 25, 2010, \$54.3 billion and \$30.8 billion, respectively, of the Company's cash, cash equivalents and marketable securities were held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings. Amounts held by foreign subsidiaries are generally subject to U.S. income taxation on repatriation to the U.S.

Deferred tax assets and liabilities reflect the effects of tax losses, credits, and the future income tax effects of temporary differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases and are measured using enacted tax rates that apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

- (a) Other corporate expenses include research and development, corporate marketing expenses, manufacturing costs and variances not included in standard costs, and other separately managed general and administrative expenses, including certain corporate expenses associated with support of the Retail segment.

The U.S. and China were the only countries that accounted for more than 10% of Company's net sales in 2011. No single country other than the U.S. accounted for more than 10% of net sales in 2010 or 2009. There was no single customer that accounted for more than 10% of net sales in 2011 or 2010. One of the Company's customers accounted for 11% of net sales in 2009. Net sales for the three years ended September 24, 2011 and long-lived assets as of September 24, 2011, September 25, 2010 and September 26, 2009 are as follows (in millions):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Net sales:			
U.S. ....	\$ 41,812	\$ 28,633	\$ 22,325
China (a) .....	12,472	2,764	769
Other countries .....	53,965	33,828	19,811
Total net sales .....	<u>\$108,249</u>	<u>\$ 65,225</u>	<u>\$ 42,905</u>
Long-lived assets:			
U.S. ....	\$ 4,375	\$ 3,096	\$ 2,348
China (a) .....	2,613	1,245	365
Other countries .....	1,090	661	480
Total long-lived assets .....	<u>\$ 8,078</u>	<u>\$ 5,002</u>	<u>\$ 3,193</u>

- (a) China includes Hong Kong. Long-lived assets located in China consist primarily of product tooling and manufacturing process equipment and assets related to retail stores and related infrastructure.

Information regarding net sales by product for the three years ended September 24, 2011, is as follows (in millions):

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Desktops (a) .....	\$ 6,439	\$ 6,201	\$ 4,324
Portables (b) .....	15,344	11,278	9,535
Total Mac net sales .....	21,783	17,479	13,859
iPod .....	7,453	8,274	8,091
Other music related products and services (c) .....	6,314	4,948	4,036
iPhone and related products and services (d) .....	47,057	25,179	13,033
iPad and related products and services (e) .....	20,358	4,958	0
Peripherals and other hardware (f) .....	2,330	1,814	1,475
Software, service and other net sales (g) .....	2,954	2,573	2,411
Total net sales .....	<u>\$108,249</u>	<u>\$ 65,225</u>	<u>\$ 42,905</u>

- (a) Includes iMac, Mac mini, Mac Pro and Xserve product lines.  
(b) Includes MacBook, MacBook Air and MacBook Pro product lines.  
(c) Includes sales from the iTunes Store, App Store, and iBookstore in addition to sales of iPod services and Apple-branded and third-party iPod accessories.  
(d) Includes revenue recognized from iPhone sales, carrier agreements, services, and Apple-branded and third-party iPhone accessories.  
(e) Includes revenue recognized from iPad sales, services and Apple-branded and third-party iPad accessories.  
(f) Includes sales of displays, wireless connectivity and networking solutions, and other hardware accessories.  
(g) Includes sales from the Mac App Store in addition to sales of other Apple-branded and third-party Mac software and Mac and Internet services.

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**Form 10-K**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the fiscal year ended September 29, 2012

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 000-10030

**APPLE INC.**

(Exact name of registrant as specified in its charter)

California  
(State or other jurisdiction of incorporation or organization)

94-2404110  
(I.R.S. Employer Identification No.)

1 Infinite Loop  
Cupertino, California  
(Address of principal executive offices)

95014  
(Zip Code)

Registrant's telephone number, including area code: (408) 996-1010

Securities registered pursuant to Section 12(b) of the Act:

Common Stock, no par value  
(Title of class)

The NASDAQ Stock Market LLC  
(Name of exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes  No

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (section 229.405 of this chapter) is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act).

Yes  No

The aggregate market value of the voting and non-voting stock held by non-affiliates of the registrant, as of March 30, 2012, the last business day of the registrant's most recently completed second fiscal quarter, was approximately \$560,356,000,000 based upon the closing price reported for such date on the NASDAQ Stock Market LLC. Solely for purposes of this disclosure, shares of common stock held by executive officers and directors of the registrant as of such date have been excluded because such persons may be deemed to be affiliates. This determination of executive officers and directors as affiliates is not necessarily a conclusive determination for any other purposes.

940,692,000 shares of common stock were issued and outstanding as of October 19, 2012.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant's definitive proxy statement relating to its 2013 annual meeting of shareholders (the "2013 Proxy Statement") are incorporated by reference into Part III of this Annual Report on Form 10-K where indicated. The 2013 Proxy Statement will be filed with the U.S. Securities and Exchange Commission within 120 days after the end of the fiscal year to which this report relates.

## Operating Expenses

Operating expenses for 2012, 2011, and 2010 are as follows (in millions, except for percentages):

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Research and development .....	\$ 3,381	\$2,429	\$1,782
Percentage of net sales .....	2%	2%	3%
Selling, general and administrative .....	\$10,040	\$7,599	\$5,517
Percentage of net sales .....	6%	7%	8%

### *Research and Development ("R&D") Expense*

R&D expense increased \$952 million or 39% in 2012 compared to 2011 and \$647 million or 36% in 2011 compared to 2010. The growth in R&D expense was driven by an increase in headcount and related expenses to support expanded R&D activities. Although total R&D expense increased 39% and 36% in 2012 and 2011, respectively, it remained fairly consistent as a percentage of net sales.

The Company continues to believe that focused investments in R&D are critical to its future growth and competitive position in the marketplace and are directly related to timely development of new and enhanced products that are central to the Company's core business strategy. As such, the Company expects to make further investments in R&D to remain competitive.

### *Selling, General and Administrative ("SG&A") Expense*

SG&A expense increased \$2.4 billion or 32% during 2012 compared to 2011 and \$2.1 billion or 38% during 2011 compared to 2010. These increases were primarily due to the Company's continued expansion of its Retail segment, increased headcount and related expenses, higher spending on professional services, marketing and advertising programs, and increased variable costs associated with the overall growth of the Company's net sales.

## Other Income and Expense

Other income and expense for 2012, 2011, and 2010 are as follows (in millions):

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Interest and dividend income .....	\$ 1,088	\$ 519	\$ 311
Other expense, net .....	(566)	(104)	(156)
Total other income/(expense), net .....	<u>\$ 522</u>	<u>\$ 415</u>	<u>\$ 155</u>

Total other income and expense increased \$107 million or 26% to \$522 million during 2012 compared to \$415 million and \$155 million in 2011 and 2010, respectively. The year-over-year increase in other income and expense during 2012 was due primarily to higher interest and dividend income on the Company's higher cash, cash equivalents and marketable securities balances, partially offset by higher premium expenses on foreign exchange contracts. The overall increase in other income and expense in 2011 compared to 2010 was attributable to higher interest income and net realized gains on sales of marketable securities. The weighted average interest rate earned by the Company on its cash, cash equivalents and marketable securities was 1.03%, 0.77%, and 0.75% during 2012, 2011, and 2010, respectively. During 2012, 2011, and 2010, the Company had no debt outstanding and accordingly did not incur any related interest expense.

## Provision for Income Taxes

The Company's effective tax rates were approximately 25.2%, 24.2%, and 24.4% for 2012, 2011, and 2010, respectively. The Company's effective rates for these periods differ from the statutory federal income tax rate of

35% due primarily to certain undistributed foreign earnings for which no U.S. taxes are provided because such earnings are intended to be indefinitely reinvested outside the U.S.

As of September 29, 2012, the Company had deferred tax assets arising from deductible temporary differences, tax losses, and tax credits of \$4.0 billion, and deferred tax liabilities of \$14.9 billion. Management believes it is more likely than not that forecasted income, including income that may be generated as a result of certain tax planning strategies, together with future reversals of existing taxable temporary differences, will be sufficient to fully recover the deferred tax assets. The Company will continue to evaluate the realizability of deferred tax assets quarterly by assessing the need for and amount of a valuation allowance.

The Internal Revenue Service (the "IRS") has completed its field audit of the Company's federal income tax returns for the years 2004 through 2006 and proposed certain adjustments. The Company has contested certain of these adjustments through the IRS Appeals Office. The IRS is currently examining the years 2007 through 2009. All IRS audit issues for years prior to 2004 have been resolved. In addition, the Company is subject to audits by state, local, and foreign tax authorities. Management believes that adequate provisions have been made for any adjustments that may result from tax examinations. However, the outcome of tax audits cannot be predicted with certainty. If any issues addressed in the Company's tax audits are resolved in a manner not consistent with management's expectations, the Company could be required to adjust its provision for income taxes in the period such resolution occurs.

#### Liquidity and Capital Resources

The following table presents selected financial information and statistics as of and for the years ended September 29, 2012, September 24, 2011, and September 25, 2010 (in millions):

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Cash, cash equivalents and marketable securities .....	\$121,251	\$81,570	\$51,011
Accounts receivable, net .....	\$ 10,930	\$ 5,369	\$ 5,510
Inventories .....	\$ 791	\$ 776	\$ 1,051
Working capital .....	\$ 19,111	\$17,018	\$20,956
Annual operating cash flow .....	\$ 50,856	\$37,529	\$18,595

As of September 29, 2012, the Company had \$121.3 billion in cash, cash equivalents and marketable securities, an increase of \$39.7 billion or 49% from September 24, 2011. The principal components of this net increase was the cash generated by operating activities of \$50.9 billion, which was partially offset by payments for acquisition of property, plant and equipment of \$8.3 billion, payments for acquisition of intangible assets of \$1.1 billion and payments of dividends and dividend equivalent rights of \$2.5 billion.

The Company's marketable securities investment portfolio is invested primarily in highly-rated securities and its investment policy generally limits the amount of credit exposure to any one issuer. The policy requires investments generally to be investment grade with the objective of minimizing the potential risk of principal loss. As of September 29, 2012 and September 24, 2011, \$82.6 billion and \$54.3 billion, respectively, of the Company's cash, cash equivalents and marketable securities were held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings. Amounts held by foreign subsidiaries are generally subject to U.S. income taxation on repatriation to the U.S. The Company believes its existing balances of cash, cash equivalents and marketable securities will be sufficient to satisfy its working capital needs, capital asset purchases, outstanding commitments, common stock repurchases, dividends on its common stock, and other liquidity requirements associated with its existing operations over the next 12 months.

#### Capital Assets

The Company's capital expenditures were \$10.3 billion during 2012, consisting of \$865 million for retail store facilities and \$9.5 billion for other capital expenditures, including product tooling and manufacturing process

## CONSOLIDATED STATEMENTS OF OPERATIONS

(In millions, except number of shares which are reflected in thousands and per share amounts)

	Years ended		
	September 29, 2012	September 24, 2011	September 25, 2010
Net sales .....	\$156,508	\$108,249	\$ 65,225
Cost of sales .....	87,846	64,431	39,541
Gross margin .....	<u>68,662</u>	<u>43,818</u>	<u>25,684</u>
Operating expenses:			
Research and development .....	3,381	2,429	1,782
Selling, general and administrative .....	10,040	7,599	5,517
Total operating expenses .....	<u>13,421</u>	<u>10,028</u>	<u>7,299</u>
Operating income .....	55,241	33,790	18,385
Other income/(expense), net .....	522	415	155
Income before provision for income taxes .....	55,763	34,205	18,540
Provision for income taxes .....	14,030	8,283	4,527
Net income .....	<u>\$ 41,733</u>	<u>\$ 25,922</u>	<u>\$ 14,013</u>
Earnings per share:			
Basic .....	\$ 44.64	\$ 28.05	\$ 15.41
Diluted .....	\$ 44.15	\$ 27.68	\$ 15.15
Shares used in computing earnings per share:			
Basic .....	934,818	924,258	909,461
Diluted .....	945,355	936,645	924,712
Cash dividends declared per common share .....	\$ 2.65	\$ 0.00	\$ 0.00

See accompanying Notes to Consolidated Financial Statements.

## Note 5 – Income Taxes

The provision for income taxes for 2012, 2011, and 2010, consisted of the following (in millions):

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Federal:			
Current .....	\$ 7,240	\$ 3,884	\$ 2,150
Deferred .....	5,018	2,998	1,676
	<u>12,258</u>	<u>6,882</u>	<u>3,826</u>
State:			
Current .....	1,182	762	655
Deferred .....	(123)	37	(115)
	<u>1,059</u>	<u>799</u>	<u>540</u>
Foreign:			
Current .....	1,203	769	282
Deferred .....	(490)	(167)	(121)
	<u>713</u>	<u>602</u>	<u>161</u>
Provision for income taxes .....	<u>\$14,030</u>	<u>\$ 8,283</u>	<u>\$ 4,527</u>

The foreign provision for income taxes is based on foreign pretax earnings of \$36.8 billion, \$24.0 billion and \$13.0 billion in 2012, 2011 and 2010, respectively. The Company's consolidated financial statements provide for any related tax liability on amounts that may be repatriated, aside from undistributed earnings of certain of the Company's foreign subsidiaries that are intended to be indefinitely reinvested in operations outside the U.S. As of September 29, 2012, U.S. income taxes have not been provided on a cumulative total of \$40.4 billion of such earnings. The amount of unrecognized deferred tax liability related to these temporary differences is estimated to be approximately \$13.8 billion.

As of September 29, 2012 and September 24, 2011, \$82.6 billion and \$54.3 billion, respectively, of the Company's cash, cash equivalents and marketable securities were held by foreign subsidiaries and are generally based in U.S. dollar-denominated holdings. Amounts held by foreign subsidiaries are generally subject to U.S. income taxation on repatriation to the U.S.

A reconciliation of the provision for income taxes, with the amount computed by applying the statutory federal income tax rate (35% in 2012, 2011 and 2010) to income before provision for income taxes for 2012, 2011, and 2010, is as follows (in millions):

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Computed expected tax .....	\$19,517	\$11,973	\$ 6,489
State taxes, net of federal effect .....	677	552	351
Indefinitely invested earnings of foreign subsidiaries .....	(5,895)	(3,898)	(2,125)
Research and development credit, net .....	(103)	(167)	(23)
Domestic production activities deduction .....	(328)	(168)	(48)
Other .....	162	(9)	(117)
Provision for income taxes .....	<u>\$14,030</u>	<u>\$ 8,283</u>	<u>\$ 4,527</u>
Effective tax rate .....	25.2%	24.2%	24.4%

The Company's income taxes payable have been reduced by the tax benefits from employee stock plan awards. For stock options, the Company receives an income tax benefit calculated as the tax effect of the difference

2011, and 2010 and long-lived assets as of September 29, 2012 and September 24, 2011 are as follows (in millions):

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Net sales:			
U.S. ....	\$ 60,949	\$ 41,812	\$28,633
China (a) .....	22,797	12,472	2,764
Other countries .....	72,762	53,965	33,828
Total net sales .....	<u>\$156,508</u>	<u>\$108,249</u>	<u>\$65,225</u>
		<u>2012</u>	<u>2011</u>
Long-lived assets:			
U.S. ....		\$ 6,012	\$ 4,375
China (a) .....		7,314	2,613
Other countries .....		2,560	1,090
Total long-lived assets .....		<u>\$15,886</u>	<u>\$ 8,078</u>

(a) China includes Hong Kong. Long-lived assets located in China consist primarily of product tooling and manufacturing process equipment and assets related to retail stores and related infrastructure.

Information regarding net sales by product for 2012, 2011, and 2010, is as follows (in millions):

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Mac desktops (a)(i) .....	\$ 6,040	\$ 6,439	\$ 6,201
Mac portables (b)(i) .....	17,181	15,344	11,278
Total Mac net sales .....	23,221	21,783	17,479
iPod(c)(i) .....	5,615	7,453	8,274
Other music related products and services (d) .....	8,534	6,314	4,948
iPhone and related products and services (e)(i) .....	80,477	47,057	25,179
iPad and related products and services (f)(i) .....	32,424	20,358	4,958
Peripherals and other hardware (g) .....	2,778	2,330	1,814
Software, service and other net sales (h) .....	3,459	2,954	2,573
Total net sales .....	<u>\$156,508</u>	<u>\$108,249</u>	<u>\$ 65,225</u>

(a) Includes revenue from iMac, Mac mini and Mac Pro sales.

(b) Includes revenue from MacBook, MacBook Air and MacBook Pro sales.

(c) Includes revenue from iPod sales.

(d) Includes revenue from sales from the iTunes Store, App Store, and iBookstore in addition to sales of iPod services and Apple-branded and third-party iPod accessories.

(e) Includes revenue from sales of iPhone, iPhone services, and Apple-branded and third-party iPhone accessories.

(f) Includes revenue from sales of iPad, iPad services, and Apple-branded and third-party iPad accessories.

(g) Includes revenue from sales of displays, networking products, and other hardware.

(h) Includes revenue from sales of Apple-branded and third-party Mac software, and services.

(i) Includes amortization of related revenue deferred for non-software services and embedded software upgrade rights.



FOREIGN INDEFINITELY REINVESTED EARNINGS:  
BALANCES HELD BY THE RUSSELL 3000

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A 5-YEAR SNAPSHOT

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## Foreign Indefinitely Reinvested Earnings: Balances Held by the Russell 3000: A 5-Year Snapshot

### Apple's Record Breaking Bond Sale

Apple, Inc. (AAPL) recently announced that it intends to use \$100 billion for dividends and share buybacks. As part of this program, during the first week in May 2013, Apple raised \$17 billion in a well-received, record-breaking bond sale. With record low interest rates available, Apple chose to borrow the money inexpensively instead of using its available cash. Apple's most recent Form 10-Q reports \$144.7 billion in cash, cash equivalents & marketable securities held at March 30, 2013. As indicated in the 10-Q, a large portion of the \$144.7 billion, a total of \$102.3 billion at quarter-end, is retained foreign earnings. The decision to sell the bonds signaled that Apple would rather issue debt securities instead of repatriating earnings held offshore. This move mimics Microsoft's and Hewlett-Packard's decisions to incur corporate debt in recent years while having cash available overseas.

### The Tax Code and Permanently Reinvested Foreign Earnings

In general, the tax code applicable to the transactions noted above is Subpart F, Section 956. In addition, further treatment is given by Accounting Principles Board Opinion No. 23 (APB 23), codified in Accounting Standards Codification ASC 740-30-05 (see also, ASC 740-30-25-17). The objective of EASB ASC Topic 740 is to recognize current and deferred income tax liability. In short, offshore passive earnings, such as royalties, are reportable under Subpart F whether or not repatriated, but under APB 23 such earnings are not reportable if a company asserts that the foreign earnings are permanently and indefinitely reinvested offshore. Therefore, for example, subsidiaries that own intellectual property licenses can maintain the cash offshore tax-free as long as the earnings are permanently reinvested overseas.

### Foreign Indefinitely Reinvested Earnings Balances of the Russell 3000

Since many companies maintain Foreign Indefinitely Reinvested Earnings (IRE) balances, Audit Analytics analyzed the amount of Foreign IRE balances held by the Russell 3000 since 2008. As shown in the table below, the total untaxed indefinitely reinvested earnings reported in 10-K filings for firms comprising the Russell 3000 for the years 2008-2012 increased by 70.3% over this period. In addition, the number of firms reporting indefinitely reinvested earnings increased by 11.4% from 2008 to 2012.

<i>Growth in Foreign Indefinitely Reinvested Earnings (IRE) Balances</i>				
Year	# of Firms with an Accumulated IRE Balance	Total Foreign Indefinitely Reinvested Earnings (Billions)	Total Assets For Firms With an IRE Balance (Billions)	Total IRE As a % of Total Assets
2012	1056	\$1,943	\$23,791	8.17%
2011	1051	\$1,684	\$22,137	7.61%
2010	972	\$1,410	\$21,052	6.70%
2009	930	\$1,473	\$19,211	7.67%
2008	948	\$1,141	\$19,390	5.88%

**Notes:** 1) The 2008 to 2011 research is based on an Audit Analytic database download of 10/3/12, supplemented with 2012 research based on a download of 4/25/13.

With interest rates near record lows, other firms holding substantial sums abroad may follow the lead of Apple and other intellectual property-intensive firms. A table listing the Top-20 companies for 2012 with Foreign IRE balances is provided below.

**Top 20 Companies for 2012 With Foreign Indefinitely Reinvested Earnings**

Company	CIK Code	Ticker	Period Ended Date	Effective Income Tax Rate	Foreign Indefinitely Reinvested Earnings (Millions)	Form Type	Total Assets (Millions)
General Electric Co.	40545	GE	12/31/12	14.00%	\$108,000	10-K	\$685,328
Pfizer Inc.	78003	PFE	12/31/12	21.00%	\$73,000	10-K	\$185,798
Microsoft Corp.	789019	MSFT	6/30/12	24.00%	\$60,800	10-K	\$121,271
Merck & Co. Inc.	310158	MRK	12/31/12	28.00%	\$53,400	10-K	\$106,132
Johnson & Johnson	200406	JNJ	12/30/12	24.00%	\$49,000	10-K	\$121,347
International Business Machines Corp.	51143	IBM	12/31/12	24.00%	\$44,400	10-K	\$119,213
Exxon Mobil Corp.	34088	XOM	12/31/12	44.00%	\$43,000	10-K	\$333,795
Citigroup Inc.	831001	C	12/31/12	0.00%	\$42,600	10-K	\$1,864,660
Cisco Systems, Inc.	858877	CSCO	7/28/12	21.00%	\$41,300	10-K	\$91,759
Apple Inc.	320193	AAPL	9/29/12	25.00%	\$40,400	10-K	\$176,064
Abbott Laboratories	1800	ABT	12/31/12	5.00%	\$40,000	10-K	\$67,235
Procter & Gamble Co.	80424	PG	6/30/12	27.00%	\$39,000	10-K	\$132,244
Hewlett Packard Co.	47217	HPQ	10/31/12	6.00%	\$33,400	10-K	\$108,768
Google Inc.	1288776	GOOG	12/31/12	19.00%	\$33,300	10-K	\$93,798
PepsiCo Inc.	77476	PEP	12/29/12	25.00%	\$32,200	10-K	\$74,638
Coca-Cola Co.	21344	KO	12/31/12	23.00%	\$26,900	10-K	\$86,174
Chevron Corp.	93410	CVX	12/31/12	43.00%	\$26,527	10-K	\$232,982
JPMorgan Chase & Co.	19617	JPM	12/31/12	26.00%	\$25,100	10-K	\$2,359,141
Amgen Inc.	318154	AMGN	12/31/12	13.00%	\$22,200	10-K	\$54,298
United Technologies Corp.	101829	UTX	12/31/12	25.00%	\$22,000	10-K	\$89,409

Notes: 1) The research is based on an Audit Analytic database download of 4/25/13.

## FOREIGN INDEFINITELY REINVESTED EARNINGS BALANCES HELD BY THE RUSSELL 3000

### Growth in Foreign Indefinitely Reinvested Earnings (IRE) Balances

Year	# of Firms with an Accumulated IRE Balance	Total Foreign Indefinitely Reinvested Earnings (Billions)	Total Assets For Firms With an IRE Balance (Billions)	Total IRE As a % of Total Assets
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## TOP 20 COMPANIES FOR 2012 WITH FOREIGN INDEFINITELY REINVESTED EARNINGS

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Pfizer Inc.	78003	PFE	12/31/12	21.00%	\$73,000	10-K	\$185,798
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